

## 13.0 SECTION 7(b)(2) RATE TEST

### 13.1 Introduction

Section 7(b)(2) of the Northwest Power Act directs BPA to conduct, after July 1, 1985, a comparison of the projected rates to be charged its preference and Federal agency customers for their general requirements with the costs of power (hereafter called rates) to those customers if certain assumptions are made. 16 U.S.C. §839e(b)(2). The effect of this rate test is to protect BPA's preference and Federal agency customers' wholesale firm power rates from certain specified costs resulting from the provisions of the Northwest Power Act. The rate test can result in a reallocation of costs from the general requirements loads of preference and Federal agency customers to other BPA loads.

The rate test involves the projection and comparison of two sets of wholesale power rates for the general requirements of BPA's public body, cooperative, and Federal agency customers (7(b)(2) customers). The two sets of rates are: (1) a set for the test period and ensuing four years assuming that section 7(b)(2) is not in effect (Program Case rates); and (2) a set for the same period taking into account the five assumptions listed in section 7(b)(2) (7(b)(2) Case rates). Certain specified costs allocated pursuant to section 7(g) of the Northwest Power Act are subtracted from the Program Case rates. Next, each nominal rate is discounted to the test year of the relevant rate case. The discounted Program Case rates are averaged, as are the 7(b)(2) Case rates. Both averages are rounded to the nearest tenth of a mill for comparison. If the average Program Case rate is greater than the average 7(b)(2) Case rate, the rate test triggers. Based on the extent to which the test triggers, the amount to be reallocated in the rate test period is calculated.

The methodology to implement section 7(b)(2) was developed in a section 7(i) proceeding that preceded BPA's 1985 rate case. The section 7(i) process culminated in the Section 7(b)(2) Implementation Methodology ROD (Implementation ROD), b-2-84-F-02. Issues regarding interpretation of the statute were resolved in the Legal Interpretation for Section 7(b)(2), b-2-84-FR-03, 49 Fed. Reg. 23,998 (1984).

To understand the context of the development of BPA's rates and the implementation of the 7(b)(2) rate test, it is helpful to review the genesis of the REP and the rate protection afforded BPA's preference customers from potential excessive costs of that program.

BPA was established by the Bonneville Project Act of 1937 (Project Act), 16 U.S.C. §832 *et seq.* After enactment of the Project Act, BPA marketed the low cost hydropower generated by Federal dams in the PNW. While section 4(a) of the Project Act requires BPA to "give preference and priority to public bodies and cooperatives" when selling power, 16 U.S.C. §832c(a), BPA had sufficient power for many years to serve the needs of all customers in the region. These customers include public bodies and cooperatives, known as "preference customers" because of their statutory first right to Federal power under the preference clause noted above. *Id.* These customers also included IOUs and DSIs. In 1948, the increasing demand for power caused BPA to require that contracts with the DSIs must include provisions to

allow the interruption of service when necessary to meet the needs of BPA's preference customers. H.R. Rep. No. 96-976, Part 2, at 28 (1980). In the 1970s, forecasts showed that preference customers soon would require all of BPA's power. *Id.* Therefore, in 1973, BPA gave notice that new contracts for firm power for IOUs would not be offered, and that as DSI contracts expired between 1981-1991, the contracts were not likely to be renewed. *Id.* at 29. In 1976, BPA advised preference customers that BPA would not be able to satisfy preference customer load growth after 1983, and would have to determine how to allocate power among preference customers. *Id.* at 30.

While Federal appropriations were used in the construction of the Federal hydrosystem, Federal taxpayers ultimately did not pay these costs. The costs of the hydrosystem are repaid with interest over time by BPA's ratepayers through BPA's wholesale power revenues. Thus, BPA's ratepayers are the parties that paid the costs of the Federal hydrosystem, not Federal taxpayers. As BPA's supply of power became unable to meet regional demand, BPA's preference customers bore more and more costs of the Federal hydrosystem.

The high cost of alternative sources of power caused BPA's non-preference customers to attempt to regain access to cheap Federal power. *Id.* at 30. Many areas served by IOUs moved to establish public entities designed to qualify as preference customers and be eligible for administrative allocations of power. Because the Project Act provided no clear way of allocating power among preference customers, and because the stakes involved in buying cheap Federal power had become very high, the competition for administrative allocations threatened to produce contentious litigation. *Id.* The uncertainty inherent in the situation greatly complicated the efforts by all BPA customers to plan for their future power needs. *Id.* at 31. In order to avoid the prospect of unproductive and endless litigation regarding access to the Federal power marketed by BPA, Congress enacted the Northwest Power Act in 1980. 16 U.S.C. §839 *et seq.*

The Northwest Power Act expressly reaffirmed the right of BPA's preference customers to first call on Federal power before such power could be offered to BPA's IOU or DSI customers. 16 U.S.C. §839g(c). The Northwest Power Act also established the REP. 16 U.S.C. §839c(c). As noted above, when BPA had insufficient Federal power to meet the needs of IOUs in the 1970s, such utilities developed their own resources, which generally were more costly than Federal hydropower. The REP provides PNW utilities a monetary form of access to low-cost Federal power. Under the program, PNW utilities may sell power to BPA at a rate based on the utility's ASC of its resources. BPA is required to purchase that power and sell, in exchange, an equivalent amount of power to the utility at BPA's PF rate. This is the same rate that applies to BPA's sales of power to its preference customers, although the Northwest Power Act expressly provides that the PF rate for the REP may be higher than the PF rate for preference customers due to the 7(b)(2) rate test described below. 16 U.S.C. §839e(b)(3). Where a utility's ASC is higher than BPA's PF rate, the difference between the rates is multiplied by the utility's jurisdictional residential load to determine an amount of money that is paid to the utility as Residential Exchange benefits. These benefits are passed through directly to the utility's residential consumers through lower retail rates. The cost of providing these benefits to exchanging utilities is borne primarily by BPA's publicly owned utility and DSI customers, subject to the rate ceiling established in section 7(b)(2) of the Northwest Power Act, which, as discussed below, protects preference customers from excessive costs of the REP.

Numerous, complex tradeoffs were necessary in order to resolve the competing claims for BPA's low-cost hydropower in the late 1970s, and in order to solve the electric power planning uncertainties facing the PNW at that time. The provisions of the Northwest Power Act reflect the give and take of those tradeoffs. While the Northwest Power Act established the REP to provide utilities a monetary form of access to low-cost Federal power, this access, or "share in the economic benefits" of Federal power, was expressly limited by a "rate ceiling" for preference customers to ensure that "[c]ustomers of preference utilities will not suffer any adverse economic consequences as a result of this exchange . . ." H.R. Rep. No. 976, Part II, 96<sup>th</sup> Cong., 2d Sess. 35 (1980); *see also* H.R. Rep. No. 976, Part I, 96th Cong., 2d Sess. 34 (1980); S. Rep. No. 272, 96th Cong., 1st Sess. 15 (1979).

The preference customer "rate ceiling" was established in section 7(b)(2) of the Northwest Power Act. Section 7(b)(2) provides that after July 1, 1985, the rates charged for firm power sold to public body, cooperative, and Federal agency customers (exclusive of amounts charged those customers for costs specified in section 7(g) of the Northwest Power Act) may not exceed in total, as determined by the Administrator, such customers' power costs for general requirements if specified assumptions are made. In determining public body and cooperative customers' power costs for any rate period after July 1, 1985, and the ensuing four years, the following assumptions are made:

- the public body and cooperative customers' general requirements had included during such five-year period the DSI loads which are: (1) served by the Administrator; and (2) located within or adjacent to the geographic service boundaries of such public bodies and cooperatives;
- public body, cooperative, and Federal agency customers were served, during such five-year period, with FBS resources not obligated to other entities under contracts existing as of the effective date of this Northwest Power Act (during the remaining term of such contracts) excluding obligations to DSI loads included in this paragraph;
- no purchases or sales by the Administrator as provided in section 5(c) were made during such five-year period;
- all resources that would have been required, during such five-year period, to meet remaining general requirements of the public body, cooperative, and Federal agency customers (other than requirements met by the available FBS resources determined under this paragraph) were: (1) purchased from such customers by the Administrator pursuant to section 6; or (2) not committed to load pursuant to section 5(b), and were the least expensive resources owned or purchased by public bodies or cooperatives; and any additional resources were obtained at the average cost of all other new resources acquired by the Administrator; and
- the quantifiable monetary savings, during such five-year period, to public body, cooperative and Federal agency customers resulting from: (1) reduced public body and cooperative financing costs as applied to the total amount of resources, other than

FBS resources, identified under this paragraph; and (2) reserve benefits as a result of the Administrator's actions under this Northwest Power Act were not achieved.

16 U.S.C. §839e(b)(2).

The legislative history of section 7(b)(2) of the Northwest Power Act repeatedly and consistently recognizes that Residential Exchange benefits are subject to elimination or reduction due to the section 7(b)(2) rate ceiling. The report of the House Committee on Interior and Insular Affairs states:

Section 5(c) of S. 885 contains provisions for a residential power "exchange." Under these provisions, any utility in the region would be entitled to sell to BPA an amount of power equal to the utility's residential and small farm load at the "average system cost" of such power and BPA would be required to sell back to each such utility an equivalent amount of power at a rate identical to what preference customers pay BPA for power to meet their "general requirements" (*subject to a "rate ceiling"*).

. . . This exchange will allow the residential and small farm consumers of the region's IOUs to share in the economic benefits of the lower-cost Federal resources marketed by BPA and will provide these consumers wholesale rate parity with residential consumers [of] preference utilities in the region. *Consumers of preference utilities will not suffer any adverse economic consequences as a result of this exchange since, as discussed below, the DSIs of BPA are required to pay the costs of the exchange during its initial years while a "rate ceiling" protects the customers of preference utilities during later years.*

H.R. Rep. No. 976, Part II, 96th Cong., 2d Sess. 35 (1980) (emphasis added). The report reiterates this point:

As an added protection against preference utilities and their customers suffering adverse economic consequences as a result of this legislation, section 7(b)(2) establishes a "rate ceiling" which is hypothetically intended to insure that these customers' rates will be no higher than they would have been had the Administrator not been required to participate in power sales or purchase transactions with non-preference customers under this legislation.

*Id.* at 36. The report emphasizes this point yet again:

Subsection 7(b)(2) establishes a "rate ceiling" for BPA's preference customers, and specifies the method of calculating this ceiling, in order to insure such customers the cost benefits of their preference rights for sales under this subsection. Amounts not recoverable from preference customers because of this ceiling are to be recovered through supplemental rate charges for all other power sold by BPA under other provisions of section 7, as subsection 7(b)(3) specifies.

*Id.* at 52.

This intent that the section 7(b)(2) rate ceiling would protect preference customers from certain costs of the Northwest Power Act, including the costs of the REP, is also contained in the report of the House Committee on Interstate and Foreign Commerce. The report states:

In addition, section 7(b) reserves for preference customers the price benefits for Federal power that they would have enjoyed in the absence of this legislation. This is accomplished by a “rate ceiling” which governs preference customer general requirements rates. Under this provision, the Northwest preference customers could pay less--but not more--for power under the legislation than they would have in any five-year period.

H.R. Rep. No. 976, Part I, 96th Cong., 2d Sess. 34 (1980). The report also notes:

Section 7(b)(2) establishes a “rate ceiling” for preference customers that seeks to assure these customers that their rates will be no higher than they would have been had the Administrator not been required to participate in power sales or purchase transactions with non-preference customers under this Northwest Power Act. The assumption[s] to be made by the Administrator in establishing this ceiling are specifically set forth. It is through rate ceilings that this Northwest Power Act provides additional protection to public bodies and cooperatives’ preference customers as to the price of the sale of power by the Administrator. In the event that this rate ceiling is triggered, then the additional needed revenues must be recovered from BPA’s other rate schedules.

*Id.* at 68-69.

The establishment of a rate ceiling for preference customers is also noted in the report of the Senate Committee on Energy and Natural Resources:

A rate test is provided in section 7 to insure that the Administrator’s power rates for public bodies and cooperatives entitled to preference and priority under the Bonneville Project Act [are] no greater than would occur in the absence of the regional program established in S. 885.

S. Rep. No. 272, 96th Cong., 1st Sess. 20 (1979). The report also states:

Section 7(b)--This section establishes a rate or rates for electric power sold to meet the general requirements (defined in this section) of public body cooperative and Federal agency customers and utilities under section 5(b)(2); a rate test to limit the charges that may be recovered by such rates applicable to public body, cooperative, and Federal agency customers after July 1, 1985; and a supplemental rate charge to recover any costs not recovered as a result of the rate test, to be applied through rates to all other power sales of the Administrator which are not limited by the rate test . . .

*Id.* at 32. This is reiterated in the Senate report. *Id.* at 56-59, 61-62. The report expressly recognizes that one item that may cause the rate test to trigger is an increase in the cost of the REP. The report states:

The rate limit would reinstate the yardstick principle which has traditionally been used to support the multiple kind of utility ownership which exists in the PNW today. Other areas which appear to cause the rate limit to apply are slower preference customer load growth than IOU load growth, lower DSI loads, and *increased IOU exchange power costs.*

*Id.* at 62 (emphasis added).

In addition to section 7(b)(2) and its legislative history, section 5(c)(4) of the Northwest Power Act establishes that Congress was well aware that section 7(b)(2) could result in reduction or complete elimination of Residential Exchange benefits for utilities participating in the REP. Section 5(c)(4) provides:

An electric utility may terminate, upon reasonable terms and conditions agreed to by the Administrator and such utility prior to such termination, its purchase and sale under this subsection if the supplemental rate charge provided for in section 7(b)(3) is applied and the cost of electric power sold to such utility under this subsection exceeds, after application of the rate charge, the ASC of power sold by such utility to the Administrator under this subsection.

16 U.S.C. §839c(c)(4). *See* S. Rep. 272, 96th Cong., 1st Sess. 15 (1979). In other words, the Northwest Power Act expressly contemplates that section 7(b)(2) could completely eliminate exchange benefits for utilities whose ASC rate was less than BPA's PF Exchange rate.

Pursuant to section 7(b)(2), BPA was required to implement the rate test for the first time in BPA's 1985 rate case. Prior to the 1985 rate case, on January 23, 1984, BPA published in the Federal Register a notice of a proposed "Legal Interpretation of Section 7(b)(2) of the PNW Electric Power Planning and Conservation Act." 49 Fed. Reg. 2911 (1984). This Legal Interpretation was intended to resolve the basic legal questions involved in the implementation of section 7(b)(2). BPA received comments and reply comments from all customers and interested parties and published a final Legal Interpretation on May 31, 1984. The Legal Interpretation has been used by BPA in every rate case since 1985 and was used in BPA's 2002 rate case.

Because of the importance and complexity of the 7(b)(2) rate test, and in order to provide customers certainty as to how section 7(b)(2) would be applied, BPA conducted a special evidentiary hearing that lasted from February 29, 1984, to August 17, 1984, to establish a Section 7(b)(2) Implementation Methodology. On March 26, 1984, BPA published in the Federal Register a notice of the *Proposed Section 7(b)(2) Implementation Methodology, Public Hearings, and Opportunities for Public Review and Comment.* 49 Fed. Reg. 11,235 (1984). BPA then conducted a formal evidentiary hearing on the methodology pursuant to section 7(i) of the Northwest Power Act. All of BPA's customers (public utilities, IOUs, and DSIs) intervened in the proceeding, in addition to state and Federal agencies and other interested parties. Both

written and oral discovery was conducted. Direct and rebuttal testimony were filed by BPA and all parties. The Hearing Officer presided over two days of cross-examination. Parties filed briefs with BPA, and BPA reviewed and responded to the briefs in a draft 7(b)(2) Methodology. Parties then filed reply briefs. BPA issued a ROD including a final 7(b)(2) Methodology on August 17, 1984. *See* Section 7(b)(2) Implementation Methodology, b-2-84-F-02. The 7(b)(2) Methodology prescribes in detail how the 7(b)(2) test is to be conducted. The ROD and the 7(b)(2) Methodology address the major issues involving the implementation of section 7(b)(2), including reserve benefits, financing benefits, natural consequences, and the rate test trigger. The 7(b)(2) Methodology has been used by BPA in every rate case since 1985, when the 7(b)(2) rate test was first run, and was used in the development of BPA's 2002 rate case.

Section 7(b)(3) of the Northwest Power Act governs the allocation of costs in the event the 7(b)(2) rate test triggers. Section 7(b)(3) provides that "[a]ny amounts not charged to public body, cooperative, and Federal agency customers by reason of paragraph (2) of this subsection shall be recovered through supplemental rate charges for all other power sold by the Administrator to all customers." 16 U.S.C. §839e(b)(3). In other words, if the rate test triggers (*i.e.*, the rate ceiling for preference customers is exceeded), the costs in excess of the ceiling must be allocated to other power sales, including sales to utilities participating in the REP. These costs increase the PF Exchange rate, which is the rate at which BPA sells power to utilities participating in the Residential Exchange. When the PF Exchange rate increases, the difference between that rate and the utility's ASC rate decreases, resulting in a reduction of Residential Exchange benefits paid to the utility. Because each exchanging utility's ASC rate and residential load are different from those of other utilities, exchange benefits differ by utility. A utility receives no benefits when its ASC rate goes below BPA's PF Exchange rate.

As noted previously, section 7(b)(2) of the Northwest Power Act requires that BPA perform a "rate test" in each rate proceeding or "when setting rates" after July 1, 1985. 16 U.S.C. 839e(b)(2). The rate test ensures that BPA's preference customers' firm power rates applied to their general requirements are no higher than rates calculated using five specific assumptions that remove certain effects of the Northwest Power Act. Kaptur *et al.*, WP-02-E-BPA-34, at 2. *See* Implementation ROD. The rate test involves the projection and comparison of two sets of wholesale power rates for the general requirements loads of BPA's public body, cooperative, and Federal agency customers (7(b)(2) or preference customers). Kaptur *et al.*, WP-02-E-BPA-34, at 2. The two sets of rates are: (1) a set for the rate filing test period (FY 2002-FY 2006) and the ensuing 4 years (FY 2007-FY 2010) assuming that section 7(b)(2) is not in effect (Program Case rates); and (2) a set for the same period taking into account the five assumptions listed in section 7(b)(2) (7(b)(2) Case rates). *Id.* The 7(b)(2) Case rates are modeled exactly the same as the Program Case rates except for the five assumptions listed in section 7(b)(2). *Id.* The five assumptions used to model the 7(b)(2) Case are:

1. Within or adjacent DSI loads are transferred to public utilities at the start of the 7(b)(2) rate test period; the remaining DSI loads are transferred to investor-owned utilities (IOUs) as BPA/DSI pre-Northwest Power Act contracts expire.
2. No section 5(c) Residential Exchange Program takes place.

3. Additional resources of three specified types serve the loads of 7(b)(2) customers when Federal Base System (FBS) resources are exhausted.
4. The DSI reserve benefits under provisions of the Northwest Power Act are not available in the 7(b)(2) Case. The 7(b)(2) Case rates will reflect this increased cost to the 7(b)(2) customers.
5. Financing benefits under provisions of the Northwest Power Act are not available in the 7(b)(2) Case. The 7(b)(2) Case rates will reflect this increased resource cost due to the absence of BPA financial backing if additional resources are required to serve 7(b)(2) customers.

*Id.* at 2-3. There may, however, be additional adjustments to reflect the natural consequences of the five assumptions. *See, e.g.,* Implementation ROD at 19-23. For a discussion of the development of the Program and 7(b)(2) Case rates, *see* Section 7(b)(2) Rate Test Study, WP-02-E-BPA-06, and Documentation, WP-02-E-BPA-06A. After the two sets of rates were developed, certain specified costs allocated pursuant to section 7(g) of the Northwest Power Act were subtracted from the Program Case rates. *Id.* at 3. Next, the nominal rate for each year was discounted to the test year of the relevant rate case, in this case FY 2002. *Id.* The discounted Program Case rates were averaged, as were the 7(b)(2) Case rates. *Id.* Both averages were rounded to the nearest tenth of a mill for comparison. *Id.* Because the average Program Case rate was higher than the average 7(b)(2) Case rate, the rate test triggered, and an adjustment to the preference customers' Priority Firm Power (PF-02) rate was required. *Id.*

In summary, BPA has implemented the 7(b)(2) rate test in the 2002 rate case in the same manner as BPA always has conducted the test. BPA followed the provisions of section 7(b)(2) of the Northwest Power Act and BPA's Legal Interpretation of Section 7(b)(2), which has been in effect since 1984. BPA also has followed the 7(b)(2) Methodology, which provides detailed directions for conducting the rate test and which also has been implemented in the same manner since it was established in 1984. The significant trigger resulting from the rate test in BPA's 2002 rate proposal is the result of running the test with the data used in developing those rates. Clearly, as evidenced by section 5(c)(4) of the Northwest Power Act, the Northwest Power Act made no guarantee of Residential Exchange benefits. By the end of FY 2001, exchange benefits have totaled approximately \$3.2 billion, and \$240 million more benefits are forecasted to be provided over the next five years under BPA's 2002 proposal. While the 7(b)(2) rate test may result in an increase in the PF Exchange rate and thus, a decrease in the amount of benefits BPA provides utilities participating in the REP, failure to implement the test properly would be contrary to law and would defeat Congress's intent to establish a rate ceiling for BPA's preference customers. Issues regarding the implementation of the 7(b)(2) rate test are addressed below.

## **13.2            Conservation**

### **Issue 1**

*Whether, in the calculation of the 7(b)(2) rate test, BPA should define conservation resources as replacements for FBS resources, and whether conservation resources in the section 7(b)(2) resource stack should be selected first to serve 7(b)(2) customer loads.*

### **Parties' Positions**

The IOUs argue that the Administrator must treat conservation as an FBS replacement, which would substantially increase Residential Exchange benefits and encourage conservation. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 16–17; IOU Ex. Brief, WP-02-B-AC/GE/IP/MP/PL/PS/EN-01, at 17-21. The IOUs argue that the Administrator should give policy direction to BPA staff responsible for performing the 7(b)(2) rate test to the effect that conservation should be included in the FBS. *Id.* The IOUs also argue that if BPA fails as a policy matter to treat conservation as an FBS replacement, the Residential Exchange benefits would be reduced by millions of dollars per year and future conservation would be discouraged. *Id.* at 19. PGE also argues that conservation should be included in the FBS. PGE Brief, WP-02-B-GE-01, at 7-8.

The PPC supports the BPA staff position that conservation resources in the 7(b)(2) rate test are not FBS resources. PPC Brief, WP-02-B-PP-01, at 72. Additionally, the PPC argues that the IOUs incorrectly argue that conservation resources must be selected from the 7(b)(2) Case resource stack first, and that BPA staff has correctly followed the prescribed treatment of conservation found in the Section 7(b)(2) Implementation Methodology ROD. *Id.*

### **BPA's Position**

Conservation does not constitute an FBS resource. Kaptur *et al.*, WP-02-E-BPA-56, at 13-15. The Implementation ROD directs that conservation is not an FBS resource. *Id.* The Northwest Power Act does not require conservation to be treated as an FBS resource.

### **Evaluation of Positions**

The IOUs argue that the Administrator should direct that conservation be included in the FBS because conservation is defined as a “resource” in the Northwest Power Act, and the term “resource” means “controlled or planned load reduction resulting . . . from a conservation measure.” 16 U.S.C. §839a(19). IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 16-17; IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 17. First, it is important to note that BPA has reviewed all of BPA’s previous rate case RODs regarding the 7(b)(2) rate test since 1985, when the rate test was first performed. *See* 16 U.S.C. §839e(b)(2). In all of those RODs where BPA conducted the 7(b)(2) rate test, not a single party ever argued that conservation should be treated as an FBS resource. As discussed in greater detail below, there are good reasons why such an argument was never proffered.

While BPA agrees that conservation is a resource, during cross-examination BPA's witnesses noted that while conservation is a resource, it is a different kind of resource than actual sources of power. Tr. 1171. BPA's witnesses also affirmed that "conservation is separate and apart from the FBS." Tr. 2223. BPA's witnesses noted that in the 7(b)(2) Case "conservation resources are added to the inventory if the FBS is insufficient." Tr. 2224. Furthermore, conservation and FBS resources are defined separately in the Northwest Power Act. Section 3(3) of the Northwest Power Act defines conservation as "any reduction in electric power consumption as a result of increases in the efficiency of energy use, production, or distribution." 16 U.S.C. §839a(3). Section 3(10) of the Northwest Power Act defines FBS resources as noted in greater detail below. 16 U.S.C. §839a(10).

The Northwest Power Act also directs that the costs of conservation and the costs of the FBS must be allocated to loads differently. Section 7(b)(1) of the Northwest Power Act specifies how the costs of FBS resources are allocated to customer loads. Section 7(b)(1) provides:

The Administrator shall establish a rate or rates of general application for electric power sold to meet the general requirements of public body, cooperative, and Federal agency customers within the PNW, and loads of electric utilities under section 5(c). Such rate or rates shall recover the costs of that portion of the *FBS resources* needed to supply such loads until such sales exceed *FBS resources*. Thereafter, such rate or rates shall recover the cost of additional electric power as needed to supply such loads, first from the electric power acquired by the Administrator under section 5(c) and then from other resources.

16 U.S.C. §839e(b)(1) (emphasis added). Section 7(g) of the Northwest Power Act specifies how the costs of conservation resources are allocated differently than the costs of FBS resources. Section 7(g) provides:

Except to the extent that the allocation of costs and benefits is governed by provisions of law in effect on the effective date of this Northwest Power Act, or by other provisions of this section, the Administrator shall equitably allocate to power rates, in accordance with generally accepted ratemaking principles and the provisions of this Northwest Power Act, all costs and benefits not otherwise allocated under this section, including, but not limited to, *conservation*, fish and wildlife measures, uncontrollable events, reserves, the excess costs of experimental resources acquired under section 6, the cost of credits granted pursuant to section 6, operating services, and the sale or inability to sell excess electric power.

16 U.S.C. §839e(f) (emphasis added).

In addition to the fact that the costs of the FBS and conservation are treated differently under the Northwest Power Act for purposes of cost allocation, conservation and FBS resources are also expressly distinguished from each other in BPA's Section 7(b)(2) Implementation ROD, b-2-84-F-02. In 1984, BPA held a formal evidentiary hearing under section 7(i) of the Northwest Power Act to develop a methodology that would be used in all subsequent BPA rate

cases to conduct the 7(b)(2) rate test. At the conclusion of the hearing, BPA issued a formal Section 7(b)(2) Implementation Methodology and an accompanying ROD. In the ROD and the 7(b)(2) Implementation Methodology, conservation resources are included as part of the three types of resources that are to be added if FBS resources are insufficient to meet 7(b)(2) customer loads:

If FBS resources, after meeting contractual obligations, are insufficient to meet the general requirements of the 7(b)(2) customers, then three types of additional resources can be added to serve those loads. These additional resources are defined in section 7(b)(2) and are: (1) actual and planned resource acquisitions by BPA from 7(b)(2) customers consistent with the program case; (2) existing 7(b)(2) customer resources not currently dedicated to their regional load; and (3) generic resources at the average cost of actual and planned resource acquisitions from non-7(b)(2) customers consistent with the program case. *These resources will include any conservation programs undertaken or acquired by BPA.* They will be assumed to come online to meet the remaining general requirements of 7(b)(2) customers *after FBS service* in order of least-cost first. The first two types of resources will come online in discrete increments, reflecting the actual size of the resource or the increment actually acquired by BPA. The third type will be brought online in the exact amount required to meet the 7(b)(2) customers' general requirements, reflecting their generic nature.

Implementation ROD, b-2-84-F-02, at 42 (emphasis added). Because the three types of resources include *any* conservation resources and are to come online *after* the FBS resources are exhausted, conservation resources cannot be FBS resources in the 7(b)(2) rate test.

This distinction between conservation and FBS resources can also be seen in the treatment of their respective costs in the COSA that BPA uses to determine the costs of resource pools and the allocation of those costs to rate pools. Kaptur *et al.*, WP-02-E-BPA-56, at 14. In the COSA06 tables, FBS resource costs are shown on lines 2-11, NR costs are shown on lines 12-17, Residential Exchange resource costs are shown on line 18, and Conservation and Energy Services Business costs are shown on lines 19 and 20. *Id.*; see Wholesale Power Rate Development Study Documentation, WP-02-E-BPA-05A, at 49-53. The costs of conservation and the costs of FBS resources are listed separately in the COSA because the Northwest Power Act prescribes different cost allocation methodologies for each of them. As noted above, section 7(b)(1) of the Northwest Power Act outlines how the costs of FBS resources, Residential Exchange resources, and new resources are allocated to rate pools. 16 U.S.C. §839e(b)(1). Section 7(g) of the Northwest Power Act outlines how other costs, including the costs of conservation, are allocated. 16 U.S.C. §839e(g). Also, as an applicable section 7(g) cost, the cost of conservation is removed from the Program Case PF rates before the calculation of the 7(b)(2) rate test trigger. 16 U.S.C. §839e(b)(2).

The IOUs and PGE argue that the Administrator should direct that conservation be included in the FBS, because the Northwest Power Act, 16 U.S.C. §839d(b) and §839b(e)(1), requires that BPA give conservation first priority when acquiring resources. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01 at 16-17; IOU Ex. Brief,

WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 17; PGE Brief, WP-02-B-GE-01, at 7. First, it must be noted that the Northwest Power Act does not simply provide that conservation is automatically a first priority in acquiring resources. BPA's conservation acquisitions are complete if BPA's Administrator determines that such acquisitions are consistent with the Regional Council's Plan. 16 U.S.C. 839d(a)(1). The Northwest Power Act also imposes cost-effectiveness and other standards for conservation acquisitions. 16 U.S.C. 839a(4)(A). If conservation fails these requirements, BPA need not acquire it. The IOUs' argument also does not establish a legal requirement that compels the Administrator to take such action. The Northwest Power Act and legislative history regarding BPA's resource acquisitions make clear that BPA is not required to treat conservation as an FBS replacement. In passing the Northwest Power Act, Congress granted the Administrator the authority to acquire resources. Section 6(a)(2) of the Northwest Power Act provides that:

In addition to acquiring electric power pursuant to section 5(c), or on a short-term basis pursuant to section 11(b)(6)(i) of the Federal Columbia River Transmission Act (Transmission System Act), the Administrator shall acquire, in accordance with this section, sufficient resources to meet [her] contractual obligations that remain after taking into account planned savings from measures provided in paragraph 1 of this subsection, and to assist in meeting the requirements of section 4(h) of this Northwest Power Act.

16 U.S.C. §839d(a)(2). The definition of FBS resources in the Northwest Power Act recognizes that BPA may acquire resources to replace reductions in capability of the FBS resources. Section 3(10) of the Northwest Power Act defines FBS resources as:

[T]he FCRPS hydroelectric projects; resources acquired by the Administrator under long-term contracts in force on the effective date of this Northwest Power Act; and resources acquired by the Administrator *in an amount necessary to replace reductions in the capability of the resources referred to in subparagraphs (A) and (B) of this paragraph.*

16 U.S.C. §839a(10) (emphasis added).

The Administrator's acquisition authority is set forth in section 6 of the Northwest Power Act. 16 U.S.C. §839d. Section 6 does not compel the Administrator to use conservation as an FBS replacement. Since implementation of the section 7(b)(2) test began, BPA has never determined that conservation is an appropriate resource for purposes of replacing reductions in the capability of the FBS, and therefore it has not been included for purposes of section 7(b)(2).

Subsection 6(a)(1) of the Northwest Power Act establishes a conditional priority for conservation and renewables to reduce the demand for electric power and thus to lessen the need to acquire power from physical generation resources. 16 U.S.C. §839d(a)(1). Subsection 6(a)(2) expands the Administrator's existing authority to acquire resources after taking into account planned savings from conservation. Subsection 6(b) defines the manner in which the Administrator is to acquire resources, including non-Federal resources to replace FBS resources. Subsection 6(b)(4) provides:

The Administrator shall acquire any non-Federal resources to replace FBS resources only in accordance with the provisions of this section. The Administrator shall include in the contracts for the acquisition of any such non-Federal replacement resources provisions which enable [her] to ensure that such non-Federal replacement resources are developed and operated in a manner consistent with the considerations specified in section 4(e)(2) of this Northwest Power Act.

16 U.S.C. §839d(b)(4). Resources that replace the FBS are to be acquired consistent with BPA's obligation to take into account the savings or planned savings from conservation.

For the long-term, section 6 authorizes the BPA to acquire 'resources' to meet these contractual obligations. However, in providing this authority, the Committee was mindful of the concerns by some this authority not provide a 'blank check' to BPA to acquire whatever resources it deems appropriate. The Committee limited that authority and set priorities . . . Further, the Committee amendment provides that BPA must first 'take into account planned savings from conservation and conservation measures.'

Senate Rep. No. 96-976, Part I, 96<sup>th</sup> Cong., 2d Sess. at 37 (1979).

The definitions of the FBS and other related terms support BPA's determination that resources acquired to replace lost capability of the FBS refers to power generation resources which have output and capability that are "compatible" with the existing regional power system. See 16 U.S.C. §839b(e)(2). The statutory predicate for replacing the FBS results from reductions in the capability of the FBS. The term "resource" is defined in section 3(19) of the Northwest Power Act and means: "(A) electric power, including the actual or planned electric power capability of generating facilities, or (B) actual or planned load reduction resulting from direct application of a renewable energy resource by a consumer, or from a conservation measure." 16 U.S.C. §839a(19)(A), (B). Finally, the term "electric power" is defined in section 3(9) to mean "electric peaking capacity, or electric energy, or both." 16 U.S.C. §839a(9). Taken together, these terms demonstrate the linkage between the FBS's capability to produce electric power, and replacement resources that produce electric energy and can replace reductions in the capability of the FBS. On the one hand, BPA is directed to seek reduction in demand for electric power consumption through conservation programs and renewable resources. On the other hand, notwithstanding the efforts to reduce demand through conservation, Congress understood that the FBS is in reality a set of physical generating resources whose reduced capability must be replaced by resources that add to the capability of the FBS.

Senate Report 96-976, Part II, 96<sup>th</sup> Cong., 2d Sess. (1980), provides further intent on FBS replacement resources. "Paragraph (3), dealing with resources acquired to replace FBS resources, clarifies that BPA will be able to require that such resources be developed and operated consistent with section 4(e)(2) of this legislation. Paragraph (4) requires BPA to continue to acquire and implement conservation measures and conservation resources and certain renewable resources pursuant to section 6(a) regardless of other resource acquisition." *Id.* at 49. Congress did not intend to bar the Administrator from acquiring "conventional" resources.

Rather, Congress struck a balance between reducing demand for electric power consumption, on the one hand, and the need to acquire power from generating resources, on the other. Because Congress specified criteria, the Administrator is compelled to “take a hard look” at non-conventional resources before determining the need to acquire conventional resources. Both the Committee statements and the language of section 6 of the Northwest Power Act acknowledge that when BPA has acquired conservation consistent with the NWPPC’s Plan, the Administrator must acquire electric power from other resources. “Section 6(b) requires BPA to acquire sufficient resources to meet its contractual obligations, after taking into account planned savings from measures provided in section 6(a)...” *Id.* at 35. At the same time, the Administrator must not reduce efforts to acquire and implement conservation measures and resources. “Thus, sections 6(a) and 6(b) together require the Administrator to achieve all available conservation and prevent [her] from acquiring non-conservation resources without first taking into account planned savings from conservation.” *Id.* at 37. In the context of replacements in the reduction of FBS resources, BPA takes into account BPA’s planned savings from conservation and then replaces reductions in the capability of the FBS resources with power producing resources.

The PPC supports BPA’s position on conservation. The PPC points out that the IOUs’ argument that conservation resources be selected first from the 7(b)(2) resource stack is based upon the Northwest Power Act requirement that conservation be given first priority, found at 16 U.S.C. §839(e)(1). The PPC argues that this citation is misleading, as it addresses BPA’s responsibilities with respect to conservation in general, and not the specific treatment of conservation resources in the 7(b)(2) rate test. PPC Brief, WP-02-E-PP-09, at 47, 72. The PPC argues that a more precise authority on treatment of conservation resources in the 7(b)(2) Case of the 7(b)(2) rate test is the Implementation ROD, which addresses this issue directly. *Id.* That document directs BPA to place all resources in the 7(b)(2) resource stack (including conservation programs undertaken or acquired by BPA) in least-cost order. *See* Implementation ROD, b-2-84-F-02, at 42. BPA has treated conservation resources in the 7(b)(2) stack consistent with the directives laid out in the Implementation ROD. *Id.*

The IOUs argue that BPA notes that the Northwest Power Act requires BPA to give conservation first priority when acquiring resources, but the IOUs do not cite any such BPA statement. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 18. As noted previously, BPA established that conservation has a conditional priority in acquiring resources and is not automatically the first resource that must be acquired. The IOUs then argue that BPA argues that there is no legal requirement that “*compels* the Administrator to take such action,” citing Draft ROD, WP-02-A-01, at 13-10 to 13-11, and that “BPA is not *required* to treat conservation as an FBS replacement, citing Draft ROD, WP-02-A-01, at 13-11. *Id.* (emphasis added by IOUs). BPA’s statements are correct. As explained in greater detail above, the Northwest Power Act and its legislative history viewed as a whole do not require that conservation be used as an FBS replacement. The conditional priority given to conservation acquisitions does not dictate that conservation must be used as an FBS replacement. Just the opposite: BPA acquires sufficient power resources to meet its contractual obligations after taking into account planned savings from measures provided in section 6(a) of the Northwest Power Act.

The IOUs argue that BPA notes that it “may acquire resources to replace reductions in the capability of the FBS resources,” citing Draft ROD, WP-02-A-01, at 13-11, and that this authority “is set forth in section 6 of the Northwest Power Act,” citing Draft ROD, WP-02-A-01, at 13-11. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 19. The IOUs then argue that BPA states that “section 6 does not compel the Administrator to use conservation as an FBS replacement,” even though BPA admits that “Subsection 6(a)(1) of the Northwest Power Act establishes a priority for conservation and renewables,” citing Draft ROD, WP-02-A-01, at 13-11. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 19. As noted above, the IOUs confuse the conditional priority of conservation with the issue of whether conservation is properly an FBS replacement resource.

The IOUs argue that BPA argues that the FBS can never include conservation as a replacement resource even though BPA acknowledges that resources include conservation under the Northwest Power Act, and that BPA concludes that “BPA has not disputed that conservation is a resource. Congress did not say, however, that conservation is an FBS resource. This is the pending issue,” citing Draft ROD, WP-02-A-01, at 13-21. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 19. Once again, the IOUs make the simplistic argument that if conservation is a resource and has a conditional priority, it must be used as an FBS replacement. As demonstrated by BPA’s lengthy legal analysis set forth above, this argument is not persuasive in light of a complete review of the Northwest Power Act and its legislative history, which distinguish conservation from generating resources in the determination of FBS replacement resources.

The IOUs argue that BPA has the issue backward: that unless there is a clear unequivocal Congressional expression of intent to exclude conservation from the FBS in order to protect preference customers and penalize residential consumers of IOUs, conservation should be included as an FBS replacement resource. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 20. BPA disagrees with the IOUs’ new and unsupported standard. The true standard is that BPA must review the statute as a whole and its legislative history and determine whether conservation was intended to be an FBS replacement resource. BPA’s thorough legal analysis determined that conservation is not an FBS replacement resource. BPA must make its determination based on the law and not based on whether its decision would protect or penalize particular customer groups.

The IOUs and PGE argue that BPA’s 7(b)(2) rate test panel believed it did not have discretion to treat conservation as an FBS resource. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 17, and PGE Brief, WP-02-B-GE-01, at 7, both citing Kaptur *et al.*, WP-02-E-BPA-56, at 14-15, and Tr. 2216-19. The IOUs argue that BPA’s witnesses viewed this as a policy issue. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 17. The IOUs argue that as a policy issue, the Administrator can direct that conservation be treated as an FBS replacement resource. *Id.* The IOUs have misrepresented BPA’s rebuttal testimony. Nowhere in the rebuttal testimony cited by the IOUs does the 7(b)(2) rate test panel state that they viewed the question of including conservation resources in the FBS as a policy issue. *Id.*; see Kaptur *et al.*, WP-02-E-BPA-56, at 14-15. Rather, the rebuttal testimony outlines the BPA panel’s understanding of the Northwest Power Act and the Implementation ROD with respect to the treatment of conservation costs in the 7(b)(2) rate test. The Northwest Power Act explicitly distinguishes between how

FBS costs are to be allocated to customer loads and how conservation costs are to be allocated to customer loads. Section 7(b)(1) of the Northwest Power Act outlines how the costs of FBS resources, Residential Exchange resources, and new resources are allocated to rate pools. 16 U.S.C. §839e(b)(1). Section 7(g) outlines how other costs, including the costs of conservation, are to be allocated. 16 U.S.C. §839e(g). In addition, the Implementation ROD expressly distinguishes between how FBS resources are to be used to serve 7(b)(2) customer loads and how conservation resources can be added to the 7(b)(2) Case resource inventory used to serve 7(b)(2) customer loads. The Implementation ROD describes the three types of resources, including any conservation resources, that are available to come online to serve 7(b)(2) customer loads after the FBS resources are exhausted. BPA's rebuttal testimony makes clear that BPA did not have discretion to treat conservation as an FBS resource, because to do so would violate BPA's understanding of the Northwest Power Act and the Implementation ROD. The issue of the treatment of conservation costs in the 7(b)(2) rate test is not a policy issue that is amenable to administrative fiat.

The IOUs have also misrepresented the cross-examination testimony of BPA's 7(b)(2) rate test panel. Nowhere in the cross-examination testimony cited by the IOUs, Tr. 2216-19, does the 7(b)(2) rate test panel state that they viewed the question of including conservation resources in the FBS as a policy issue. The panel repeatedly stated that they did not consider conservation to be an FBS resource. Tr. 2217-18. The panel stated that historical conservation could not be part of the FBS in the 7(b)(2) Case, because the 7(b)(2) Case stack of resources to be used in the event that the FBS is insufficient to serve 7(b)(2) customer loads included programmatic conservation for each year starting in 1981. Tr. 2218-19. Particularly telling is that during cross-examination, counsel for the IOUs described the issue of conservation in the FBS as a legal issue, not a policy issue:

“Q. Assume we have a debate, just for the purposes of this question, and that conservation is in the FBS already, if you make that assumption, *which is a legal conclusion*, then your sentence in the ROD could be interpreted to mean ...”

Tr. 2219 (emphasis added). The IOUs' own statements admit that the issue of whether conservation should be part of the FBS is a legal issue, not a policy issue. BPA's rebuttal testimony and cross-examination testimony, as well as the IOUs' own admissions, all support BPA's position that the question of including conservation resources in the FBS is a legal issue, not a policy issue as the IOUs now contend.

The IOUs argue that nothing in the Northwest Power Act precludes the BPA Administrator from treating conservation as an FBS resource. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 17, citing Tr. 2219. First, BPA's panel was not comprised of lawyers. BPA's witnesses are therefore not able to make legal conclusions. Nevertheless, the 7(b)(2) panel's understanding of the Northwest Power Act is that there is no explicit language prohibiting conservation resources from being treated as FBS resources, nor is there explicit language requiring that conservation resources be treated as FBS resources. Tr. at 2216. Obviously, this does not mean that conservation resources are FBS resources. Upon further legal analysis, as noted above and as discussed in further detail below, there is explicit language in the Northwest Power Act that distinguishes between conservation resources and FBS resources in terms of how they are used

to serve loads and how their costs are allocated to customer loads. These explicit distinctions, and more detailed arguments discussed below, establish that conservation resources and FBS resources are not one and the same. Also as stated above, the Implementation ROD and BPA's interpretation of the Northwest Power Act make an explicit distinction between conservation resources and FBS resources used to serve 7(b)(2) customer loads in the 7(b)(2) Case of the 7(b)(2) rate test.

In addition, on pages 4 and 5 of the Implementation ROD, there is a discussion about the concern that three parties had about the possible double-counting of conservation costs in the 7(b)(2) rate test. It was determined in this discussion that, while it may be theoretically possible for some or all conservation costs to be double-counted, it did not occur in all instances:

This is because billing credits and programmatic conservation are added to the resources used to serve the 7(b)(2) customers only to the extent that they are needed after the FBS is exhausted and only in the event that they are the least-cost resources to be added. If the FBS is sufficient to serve the 7(b)(2) load, or other available additional resources have lower costs, then billing credits and programmatic conservation will not be added to the 7(b)(2) case.

Implementation ROD, b-2-84-F-02, at 5. The clear language in both the Northwest Power Act and the Implementation ROD preclude the Administrator from treating conservation as an FBS resource in the 7(b)(2) rate test.

The IOUs argue that if BPA includes conservation in the FBS, BPA will increase residential benefits and will encourage cost-effective conservation. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 17. The IOUs state that BPA's 7(b)(2) rate test panel agrees that including conservation in the FBS encourages cost-effective conservation. *Id.*, citing Kaptur *et al.*, WP-02-E-BPA-56, at 15. Once again the IOUs have misrepresented BPA's rebuttal testimony. The actual text of the relevant answer is:

- A. BPA agrees with the general theoretical argument that if electric power costs were made to be artificially high in the PNW, conservation would be a comparatively more cost-effective alternative. However, BPA does not believe that higher energy costs are a net benefit to the region.

Kaptur *et al.*, WP-02-E-BPA-56, at 15, lines 18-21. This subject was also brought up by the IOUs' attorney during the cross-examination of the BPA's 7(b)(2) rate test panel:

- Q. (Mr. Marshall) You agreed that if other rates went up, electric power costs rates went up, that conservation would become comparatively more cost-effective as an alternative. Right?
- A. (Mr. Doubleday) We were answering an IOU argument that seems to have said that since conservation is a good thing, that higher rates in the region would foster more of this good thing so, therefore, higher rates would be a good thing. And I think we said that, however, BPA does not believe that higher energy costs are a net benefit to the region.

Tr. 2220. Whether conservation is a more or a less cost-effective alternative to BPA power sales is not a consideration when performing the 7(b)(2) rate test. BPA staff responsible for conducting the test are directed by their understanding of the Northwest Power Act and the Implementation ROD. The PPC noted that the IOUs suggest that one benefit of treating conservation as they suggest in the 7(b)(2) Case would be to artificially increase rates to BPA's preference customers so as to make conservation relatively more cost-effective. PPC Brief, WP-02-B-PP-01, at 72-73, citing Hoff *et al.*, WP-02-E-AC/GE/IP/MP/PL/PS-03, at 28. BPA's witnesses have said that raising cost-based rates while lowering rates to BPA's other customers for the purpose of promoting conservation is not consistent with the purpose of section 7(b)(2) of the Northwest Power Act. PPC Brief, WP-02-B-PP-01, at 73; Tr. 2247-48.

The IOUs argue that Congress did not intend to insulate preference customers from the costs of conservation and that Congress wanted to encourage conservation, but BPA would protect preference customers from conservation costs and discourage conservation by establishing artificially low rates for preference power instead of treating conservation as an FBS replacement and increasing Residential Exchange benefits and encouraging conservation. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 17. BPA disagrees with this argument. First, the preference customers' PF Preference rate is not insulated from the costs of conservation. The PF Preference rate contains such costs. While Congress wanted to encourage conservation, it is still doing so through BPA's many conservation programs and expenditures. Further, BPA is not establishing artificially low rates for preference customers or high rates for exchange customers; instead, BPA is properly not including conservation as an FBS replacement resource. This is a correct decision and its effect on the PF rate or the PF Exchange rate is not the basis for BPA's decision.

The IOUs cite a number of statements made by BPA's general policy witnesses during cross-examination. These witnesses did not do any work regarding BPA's determination that conservation resources are not FBS resources, and are not lawyers and are not qualified to perform legal analyses regarding whether conservation is an FBS resource under the Northwest Power Act. Indeed, counsel for the IOUs expressly admitted that the issue of whether conservation is an FBS resource is a legal issue. Tr. 2219. Throughout their cross-examination regarding the treatment of conservation in the 7(b)(2) rate test, BPA's policy witnesses were asked legal questions and technical questions by the IOUs' attorney that they were not qualified to answer. BPA's policy witnesses testified that while they were not technical experts on the 7(b)(2) rate test, they did know that the test followed a prescribed methodology, including about how conservation was treated. Tr. 133. BPA's policy witnesses testified that their understanding is that the 7(b)(2) panel performing the 7(b)(2) rate test were "... not being driven by the dollar amount and/or other factors, but trying to stay true to what the test requires. That's the fundamental thing driving them there." Tr. 137. BPA's policy witnesses testified repeatedly that they were not qualified to determine if conservation had been used or should be used to replace some of the capability of the FBS. One of BPA's policy witnesses testified that "[t]he term 'replacements' I think might carry with it, dare I say, a technical term in that I believe there is some statutory limits to the way and amount of Federal Base System that Bonneville replaces. And I'm not qualified to get into an expansive or probably even a narrow discussion of FBS replacement as it pertains to statute." Tr. 140. BPA's other policy witness testified that "...but once again you're stretching beyond at least my ability to probably give you concise, clear

answers about all requirements when it comes to what does or doesn't qualify for ratemaking purposes replacement to the Federal Base System. I think there are some other panels coming up who could get at that." Tr. 139. BPA's policy witnesses recognized that the legal/technical issue of the treatment of conservation in the 7(b)(2) rate test is not a policy issue, and repeatedly stated that as policy witnesses they did not feel qualified to address that issue.

The IOUs argue that BPA's general policy witness said that 724 aMW of conservation have replaced FBS resources in the ordinary sense of the word. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 18-19, citing Tr. 141. As noted previously, BPA's policy witnesses' conceptions of whether conservation has replaced FBS resources, which are made in the absence of knowledge about section 7(b)(2) of the Northwest Power Act, the Section 7(b)(2) Legal Interpretation, or the Section 7(b)(2) Implementation Methodology, do not state and are not used in BPA's determination of that issue, which is guided by legal and technical analyses. The logical meaning of the witness's statement is that if BPA loses power from resources, conservation programs that reduce demand can be generally viewed, even if not technically or legally correct with regard to FBS replacements, as making up for such losses. When viewed by BPA's legal and technical experts who did the actual work on this issue, this simplistic understanding is clearly wrong. The Northwest Power Act plainly establishes that resources do not automatically replace reductions in the capability of the FBS as suggested by the IOUs. BPA must take particular actions in determining whether resources replace such reductions. 16 U.S.C. §839d. The record does not establish that BPA ever took such actions regarding conservation, and therefore conservation has never been an FBS resource. In addition, directly contrary to the IOUs' arguments, BPA's witnesses testified that "BPA has *never* proposed that conservation be used as an FBS replacement." Kaptur *et al.*, WP-02-E-BPA-56, at 15 (emphasis added).

The IOUs argue that BPA's witness could offer no policy reason why BPA would not want to define and treat conservation as an FBS replacement. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 19. This issue, however, is not a policy issue. This is a legal and technical issue. BPA's legal and technical reasons for not treating conservation as an FBS replacement are stated at great length in this ROD. These reasons establish that, regardless of whether there is or is not a policy reason to treat conservation as an FBS replacement, legally and technically it is inappropriate to do so.

The IOUs argue that BPA does not address the adverse consequences of not including conservation in the FBS from the perspective of Congressional intent. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 20. The IOUs argue that the adverse effects are reductions in Residential Exchange benefits by tens of millions of dollars per year. *Id.* The IOUs argue that BPA does not argue that Congress intended to penalize residential consumers of IOUs by excluding conservation from the FBS. *Id.* The IOUs argue that the legislative history of the Northwest Power Act shows that conservation was a Congressional priority, and it was to be paid for by all customers. *Id.* The IOUs argue that the effect of not treating conservation as an FBS resource is to protect preference customers from the cost of conservation and create a rate disparity Congress never intended. *Id.* The IOUs argue that BPA provides no compelling reason why it would choose to protect one set of customers from conservation costs that Congress intended all regional customers to share. *Id.* First, BPA has addressed the issue of the

consequences of making determinations on section 7(b)(2) issues from the perspective of Congressional intent. As discussed at great length in the introduction to this chapter, the Northwest Power Act expressly contemplates that section 7(b)(2) could completely eliminate exchange benefits for utilities whose ASC was less than BPA's PF Exchange rate. There is no statutory guarantee to any particular level of benefits for exchanging utilities. In addition, BPA previously presented a thorough legal analysis regarding why Congressional intent, as reflected in the Northwest Power Act and its legislative history, support the proposition that conservation was not intended to be an FBS replacement resource. The legislative history of the Northwest Power Act does not provide that conservation was to be an FBS replacement resource. The costs of conservation are paid for by all customers through an allocation under section 7(g) of the Northwest Power Act, not through the treatment of conservation as an FBS resource in the section 7(b)(2) rate test. With regard to the argument that the preference customers' PF Preference rate is insulated from the costs of conservation, to the contrary, the PF Preference rate contains such costs. While Congress wanted to encourage conservation, it is still doing so through BPA's many conservation programs and expenditures. Further, BPA is not establishing artificially low rates for preference customers or high rates for exchange customers; instead, BPA is properly not including conservation as an FBS replacement resource. This is a correct decision, and its effect on the PF rate or the PF Exchange rate is not the basis for BPA's decision. While the IOUs argue that the effects of this decision reduce Residential Exchange benefits by tens of millions of dollars per year, if BPA adopted the erroneous position of the IOUs, this would similarly create adverse effects of tens of millions of dollars per year for BPA's preference customers and deny such customers their statutory rate protection under section 7(b)(2). BPA's decision is made on its merits, not to penalize or reward any particular customer or customer class.

The IOUs argue that BPA's general policy witness acknowledged that conservation was a main goal of BPA and the Northwest Power Act. *Id.*, citing Tr. 134. BPA has never disputed that conservation is a main goal of the Northwest Power Act. This does not mean, however, that BPA should ignore the legal and technical reasons why it is inappropriate to include conservation as an FBS resource. The IOUs also argue that BPA's witness agreed that conservation is defined as a "resource under the 1980 Northwest Power Act." *Id.*, citing Tr. 135-136. While, technically, the definition of conservation in the Northwest Power Act does not define conservation as a resource, 16 U.S.C. §839a(3), the definition of resource in the Northwest Power Act includes conservation, 16 U.S.C. §839a(19). Again, BPA has never disputed this, but this does not mean that BPA should ignore the legal and technical reasons why it is inappropriate to include conservation as an FBS resource.

The IOUs argue that BPA's general policy witness stated that there is "nothing wrong with conservation as a replacement," if BPA loses other FBS resources, *Id.*, citing Tr. 136-137; and that "there are certain priorities given to conservation when it comes to replacement of the FBS." *Id.*, citing Tr. 136-137. Again, as noted above, BPA's policy witnesses did not do any work regarding BPA's determination that conservation resources are not FBS resources, and are not lawyers and are not qualified to perform legal analyses regarding whether conservation is an FBS resource under the Northwest Power Act. Indeed, counsel for the IOUs expressly admitted that the issue of whether conservation is an FBS resource is a legal issue. Tr. 2219. BPA's policy witnesses testified repeatedly that they were not qualified to determine if conservation had been

used or should be used to replace some of the capability of the FBS. Tr. 139, 140. BPA's policy witnesses recognized that the legal and technical issue of the treatment of conservation is not a policy issue, and repeatedly stated that as policy witnesses they did not feel qualified to address that issue. When viewed by BPA's legal and technical experts who did the actual work on this issue, however, this simplistic understanding is clearly wrong. As previously noted in great detail, it is inappropriate to treat conservation as an FBS replacement. The IOUs also argue that BPA's policy witness stated that "there are certain priorities given to conservation when it comes to replacement of the FBS." IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 18. The immediately foregoing responses apply equally to this argument. BPA's policy witnesses have no knowledge of whether conservation legally can be an FBS replacement. Therefore, they have no knowledge of whether there are priorities regarding conservation in that circumstance. Notably, the BPA witnesses that are experts on the 7(b)(2) rate test and were responsible for the determination of whether conservation should be viewed as an FBS resource filed detailed testimony that disagreed with the admittedly uninformed answers given by BPA's policy witnesses. BPA's policy witnesses admitted extremely limited knowledge about the 7(b)(2) rate test and FBS replacements and deferred to BPA's expert panels that actually conducted the analysis on these issues.

The IOUs argue that BPA's general policy witness testified that from 1980 to now, BPA has acquired 724 aMW of conservation and that if BPA had not acquired that conservation "you would have had to build other resources or find other replacements for that power." *Id.*, citing Tr. 140. The IOUs argue that BPA also testified that since December 5, 1980, the capability of the FBS has decreased by more than 2,600 aMW, and in that period of time BPA added 724 aMW of conservation. *Id.*, citing Tr. 2221; IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 17. These arguments mean little. With regard to the argument that absent BPA's conservation efforts, BPA would have had to find power, this does not mean that the power acquisitions would be FBS replacements. In section 7(b)(1), the Northwest Power Act recognizes that BPA can acquire "other" power. In BPA ratemaking, such power constitutes new resources, not FBS resources. Wholesale Power Rate Development Study Documentation, WP-02-E-BPA-05A, at 38. FBS resources, exchange resources, and new resources are all separately established in the Northwest Power Act. 16 U.S.C. §839e. New resources are allocated differently than FBS resources. *Id.* As noted previously, replacements of reductions in the FBS are not automatic. As BPA noted, BPA previously proposed to replace reductions in the FBS only one time, in 1996, and issued letters as part of a public process to make a determination regarding FBS replacements. Tr. 1163-64. BPA also established that "BPA has never proposed that conservation be used as FBS replacements." Kaptur *et al.*, WP-02-E-BPA-56, at 15. This means that the 724 aMW of conservation never became FBS resources. Thus, that reductions in the capability of the FBS comprise over 2,600 aMW and that BPA's conservation efforts have produced 724 aMW of savings does not establish that the latter replaced reductions in the capability of the FBS.

The IOUs argue that BPA's technical panel has taken a tortured and narrow interpretation of an internal implementation decision, to conclude that conservation was not technically a replacement, despite the plain words of the statute and the plain fact that conservation has been acquired and has replaced lost FBS resources. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 19-20, citing Implementation ROD, b-2-84-F-02; IOU Ex. Brief,

WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 18, 20-21. The IOUs go on to argue that the BPA panel points to the Implementation ROD, at 42, which, *the IOUs claim*, states that “If FBS resources . . . are insufficient to meet the general requirements of 7(b)(2) customers, then three types of additional *conservation* resources can be added to meet these loads.” *Id.*, citing Kaptur *et al.*, WP-02-E-BPA-56, at 13. The IOUs argue that but for conservation that is in the FBS, that sentence is simply not applicable, because that sentence addresses only treatment of conservation after the FBS is determined to be insufficient. *Id.* The IOUs argue that the Implementation ROD can be read to assume that the FBS is full and therefore, did not address the addition of conservation to the FBS. *Id.*

Contrary to the IOUs’ arguments, BPA has previously established that the plain words of the statute do not show that conservation is an FBS replacement. Quite the opposite, the plain words of the statute and its legislative history establish that conservation was not intended to be an FBS replacement. In addition, contrary to the IOUs’ arguments, BPA has established the plain fact that conservation has never been acquired to replace reductions in the capability of FBS resources.

With regard to the IOUs’ remaining arguments, the IOUs have once again misrepresented BPA’s rebuttal testimony. In this case, the IOUs have gone beyond mere misrepresentation of the BPA panel’s rebuttal testimony and have actually fabricated new language for the Implementation ROD. The IOUs then use their fabricated language to support their arguments. BPA’s Implementation ROD states:

If FBS resources, after meeting contractual obligations, are insufficient to meet the general requirements of the 7(b)(2) customers, *then three types of additional resources can be added to serve those loads*. These additional resources are defined in section 7(b)(2) and are: (1) actual and planned resource acquisitions by BPA from 7(b)(2) customers consistent with the program case; (2) existing 7(b)(2) customer resources not currently dedicated to their regional load; and (3) generic resources at the average cost of actual and planned resource acquisitions from non-7(b)(2) customers consistent with the program case. *These resources will include any conservation programs undertaken or acquired by BPA.*

Kaptur *et al.*, WP-02-E-BPA-56, at 13, lines 17-22 (emphasis added). As noted above, the actual language of the Implementation ROD, at 42 states: “three types of additional resources can be added to serve those loads.” The IOUs, however, do not quote the actual language of the Implementation ROD, but present a quotation of the language amended in a manner that attempts to favor their case. The IOUs’ fabricated quotation states: “three types of additional *conservation* resources can be added to meet loads.” (Emphasis added.) The IOUs’ fabrication attempts to imply that conservation was already a part of the FBS, and that the Implementation ROD was referring to the additional conservation that could be added over and above that which was already in the FBS. The actual language of the Implementation ROD is clear and is contrary to the IOUs’ fabrication. The resources available for serving 7(b)(2) customer load after the FBS resources are exhausted include any conservation programs undertaken or acquired by BPA. The resources available for serving 7(b)(2) customer load after the FBS resources are exhausted are

shown in the 7(b)(2) Case resource stack. *See* 7(b)(2) Rate Test Study Documentation, WP-02-E-BPA-06A, at 49. The 7(b)(2) Case resource stack shows conservation resources for each year starting in 1982. *Id.* Logically, if all BPA programmatic conservation is included in the resources to be used after FBS resources are exhausted, then the FBS resources cannot contain any of these same BPA programmatic conservation resources.

Incredibly, the IOUs go on to argue that their fabricated Implementation ROD language (“[i]f FBS resources ... are insufficient to meet the general requirements of 7(b)(2) customers, then three types of additional conservation resources can be added to meet these loads”) can be rephrased with no change in meaning to reflect the inclusion of conservation as an FBS resource:

If existing FBS *conservation and other* resources ... are insufficient to meet the general requirements of the 7(b)(2) customers, then three types of *additional* conservation and other resources can be added to serve those [7(b)(2)] loads ...

IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 20. The IOUs’ attempt to fabricate language and then to use a paraphrase of that fabrication to support the manner in which they would like to see an issue resolved is extremely disturbing. BPA staff, however, must be directed by the actual language in the Northwest Power Act and the Implementation ROD when conducting the 7(b)(2) rate test. The actual language of the ROD clearly establishes that conservation resources are *not* to be considered to be part of the FBS resources, either in the Program Case or in the 7(b)(2) Case of the 7(b)(2) rate test. The IOUs’ argument that their fabricated language can be read in yet a different way to support their position on the treatment of conservation resources in the 7(b)(2) Case is obviously not persuasive.

In their brief on exceptions, the IOUs argue that BPA committed an uncalled-for and specious attack on the IOUs’ argument that the term “resources” could be read to mean conservation and other resources. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 18. The IOUs have mischaracterized BPA’s criticism. BPA did not criticize the IOUs for making their argument, BPA criticized the IOUs’ fabrication of language in BPA’s Implementation ROD in an attempt to bolster their argument. BPA’s criticism is therefore neither uncalled-for nor specious. Such improper conduct cannot be ignored.

The IOUs argue that BPA’s 7(b)(2) rate test panel said the IOUs’ foregoing interpretation is one of a “family of interpretations” that could be used. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 20, citing Tr. 2219. Again, the IOUs have misrepresented BPA’s cross-examination testimony. A true statement of the question and answer follows:

Q. (Mr. Marshall) Assume we have a debate, just for the purposes of this question, *and that conservation is in the FBS already, if you make that assumption, which is a legal conclusion*, then your sentence in the ROD could be interpreted to mean that if existing FBS resources are insufficient to meet 7(b)(2) customer loads, additional resources, including three types that you quote on lines 19 through 21 of your testimony, are to be added.

A. (Mr. Keep) Right. As you so amended it, given your caveats, of the family of interpretations that you could then put on it, that may be one of them.

Tr. 2219 (emphasis added). First, as is evident throughout this section of BPA's ROD, conservation resources cannot be used as FBS replacements. BPA's COSA and 7(b)(2) witnesses did not say otherwise. With regard to the IOUs' foregoing argument, BPA's witness was clearly answering a hypothetical question posed by the IOU attorney that specified that conservation was assumed to be in the FBS already, and was not agreeing with the IOUs' fabricated Implementation ROD language cited above.

The IOUs argue that BPA cannot hide behind one of its own ambiguous and vague implementation decisions to deny what Congress intended. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 21. The IOUs argue that Congress expressly defined conservation as a "resource," 16 U.S.C. §839(a)(B). *Id.* The IOUs argue that Congress intended to provide Residential Exchange benefits that are not diminished by the failure to subtract conservation costs in the 7(b)(2) test. *Id.* The IOUs argue that BPA, in an argument so convoluted as to defy understanding, has denied the plain meaning of these Congressional mandates. *Id.* The IOUs argue that the end result is to deny millions of dollars a year of benefits to residential and rural customers of the region and to discourage conservation. *Id.* at 20-21.

The IOUs' argument that BPA cannot hide behind one of its own "ambiguous and vague" implementation decisions to deny what Congress intended is clearly unfounded. First, BPA's Section 7(b)(2) Implementation Methodology is hardly a generic implementation decision. As noted previously, in 1984, BPA held a formal evidentiary hearing under section 7(i) of the Northwest Power Act to develop a methodology that would be used in all subsequent BPA rate cases to conduct the 7(b)(2) rate test. At the conclusion of this extensive and contested hearing, BPA issued a formal Section 7(b)(2) Implementation Methodology and an accompanying ROD. This was no mere implementation decision, this was the establishment of an important methodology that would guide BPA ratemaking for years to come. Furthermore, the IOUs' argument that the Implementation Methodology is "ambiguous and vague" is utterly unsupported. As noted above, the Implementation ROD clearly states that "[i]f FBS resources, after meeting contractual obligations, are insufficient to meet the general requirements of the 7(b)(2) customers, *then three types of additional resources can be added to serve those loads. . . These resources will include any conservation programs undertaken or acquired by BPA.*" Kaptur *et al.*, WP-02-E-BPA-56, at 13.

The IOUs argue that Congress expressly defined conservation as a resource. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 21. As noted above, BPA has not disputed that conservation is a resource. Congress did not say, however, that conservation is an FBS resource. This is the pending issue. As for the IOUs' argument that Congress intended to provide Residential Exchange benefits that are not diminished by the failure to subtract conservation costs in the 7(b)(2) rate test, BPA has explained previously that this was not Congress's intent with regard to FBS replacements, as evidenced by the Northwest Power Act and its legislative history. While the IOUs claim that their benefits have been reduced due to BPA's failure to subtract conservation costs, conservation costs are and always have been subtracted from the Program Case rates in the 7(b)(2) rate test, including in the current case.

While the IOUs argue that BPA's argument is "so convoluted as to defy understanding," this *ad hominem* attack is unfounded. As seen from the extensive preceding discussion, BPA's analysis is straightforward and logical. While the IOUs profess not to understand BPA's argument regarding the treatment of conservation in the 7(b)(2) rate test, BPA has followed the very same treatment of conservation costs in all previous rate cases where the test was conducted, going back to 1985. The IOUs have apparently not understood BPA's position despite having the last 15 years to do so. In this rate case, BPA has used the language of the Northwest Power Act, its legislative history, the 7(b)(2) Implementation Methodology ROD, BPA's direct and rebuttal testimony, and BPA's cross-examination testimony to support its longstanding position. The IOUs, on the other hand, have repeatedly misrepresented BPA's testimony and fabricated new language in the Implementation ROD in an attempt to support their position, a position they have never previously taken since the inception of the 7(b)(2) rate test in 1985. While the IOUs argue that the exclusion of conservation from the FBS is arbitrary and capricious and an abuse of discretion and violates Congressional intent, IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 21, BPA's foregoing review of this issue establishes that BPA's position is well-reasoned, consistent with Congressional intent, and supported by the administrative record and the law.

### **Decision**

*BPA continues to treat conservation costs in the 7(b)(2) rate test as conservation costs and not FBS costs. Conservation resources are not part of the FBS. As expressly prescribed by the 7(b)(2) Implementation Methodology, conservation resources are placed in the 7(b)(2) resource stack with other available resources in order of least-cost first.*

## **13.3            Costs of Uncontrollable Events**

### **13.3.1        Planned Net Revenues for Risk**

#### **Issue 1**

*Whether BPA's PNRR constitute the costs of uncontrollable events and thus should be excluded from the Program Case.*

### **Parties' Positions**

The IOUs argue that the costs of PNRR (over \$127 million per year for five years) are costs of uncontrollable events that should be subtracted from the "program case" of the 7(b)(2) rate test. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 23. The IOUs argue that PNRR are by definition a cost for risks of events that cannot be controlled. *Id.* at 24.

PPC argues that PNRR do not constitute a cost of uncontrollable events. PPC notes that PNRR is an element of BPA's risk analysis, which mitigates for a wide yet identified range of uncertainties in factors such as hydro conditions and market prices. PPC Brief, WP-02-B-PP-01, at 70. In addition, PPC notes that "[u]ncontrollable events" is a statutory term referring to discrete events which differ from the continuum of changing events that occur in nature, business and government." *Id.*, quoting Kaptur *et al.*, WP-02-E-BPA-56, at 11.

## **BPA's Position**

PNRR do not constitute the costs of uncontrollable events. Kaptur *et al.*, WP-02-E-BPA-56, at 11-13. PNRR should not be excluded from the Program Case, because BPA has not identified any costs as being costs of uncontrollable events in this rate case. *Id.* at 11. The cost of mitigating a wide range of uncertainties is not the same as the cost of uncontrollable events. *Id.* at 12. PNRR costs are not the costs of uncontrollable events and should not be included in the section 7(g) adjustment in the 7(b)(2) rate test. *Id.* at 13.

## **Evaluation of Positions**

Section 7(b)(2) of the Northwest Power Act provides that:

After July 1, 1985, the projected amounts to be charged for firm power for the combined general requirements of public body, cooperative and Federal agency customers, *exclusive of amounts charged such customers under subsection (g) for the costs of conservation, resource and conservation credits, experimental resources and uncontrollable events*, may not exceed in total, as determined by the Administrator, during any year after July 1, 1985, plus the ensuing four years, an amount equal to the power costs for general requirements of such customers if, the Administrator assumes that . . .

16 U.S.C. §839e(b)(2) (emphasis added).

Section 7(g) of the Northwest Power Act provides that:

Except to the extent that the allocation of costs and benefits is governed by provisions of law in effect on the effective date of this Northwest Power Act, or by other provisions of this section, the Administrator shall equitably allocate to power rates, in accordance with generally accepted ratemaking principles and the provisions of this Northwest Power Act, all costs and benefits not otherwise allocated under this section, including, but not limited to, conservation, fish and wildlife measures, uncontrollable events, reserves, the excess costs of experimental resources acquired under section 6, the cost of credits granted pursuant to section 6, operating services, and the sale or inability to sell excess electric power.

16 U.S.C. §839e(g). The analysis of whether there are costs of “uncontrollable events” that should be excluded from the Program Case must begin with an interpretation of this statutory term. The IOUs argue that the plain meaning of the word “event” is defined as “something that happens,” which is not limited in any manner whatsoever and applies to any occurrence that is beyond BPA’s control. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 23, n. 62. The IOUs also argue that BPA is trying to quantify and limit a term in a way that the plain words Congress used does not limit. *Id.* at 23. The IOUs’ proposed interpretation, however, makes little sense in the context of the 7(b)(2) rate test. There are millions of “events” that occur daily and which are beyond BPA’s control. It is impossible to identify each event that has occurred and which might

have some impact on BPA's costs. Congress could not reasonably have intended to impose such an elusive and impractical standard upon BPA. This is confirmed by a review of the statutory context of this term. BPA must interpret the statute in a manner that is consistent with the context in which it is used, that is, the 7(b)(2) rate test. As noted previously, the 7(b)(2) rate test compares PF rates for preference customers under two scenarios: with and without the specific assumptions of section 7(b)(2). This fact suggests that Congress intended the comparison to be between rates that share the same basic costs but for the specific statutory exceptions. For this reason, uncontrollable events should be construed such that they do not exclude costs from the Program Case that are due to conditions that simply vary over time and which typically are reflected in rates. For this reason, uncontrollable events are not properly viewed as all conceivable events beyond BPA's control, but rather the discrete and significant events beyond BPA's control that differ from the continuum of changing conditions that occur in nature, business, and government and are routinely reflected in rate development.

Section 7(b)(2) of the Northwest Power Act excludes certain applicable section 7(g) costs, including the costs of uncontrollable events, from the Program Case. Section 7(b)(2) refers to "the projected amounts to be charged for firm power for the combined general requirements of public body, cooperative and Federal agency customers, *exclusive of amounts charged such customers under subsection (g) for the costs of . . . uncontrollable events . . .*"

16 U.S.C. §839e(b)(2) (emphasis added). The exclusion of the costs of uncontrollable events from the Program Case is tied expressly to the "amounts *charged* such [preference] customers under subsection (g) for the costs of . . . uncontrollable events." In other words, one must look to the costs of uncontrollable events that actually were "charged" to preference customers in the Program Case, which reflects BPA's rate proposal. This is confirmed by BPA's Legal Interpretation of Section 7(b)(2), which emphasizes that applicable 7(g) costs are only those "chargeable to 7(b)(2) customers." See Legal Interpretation of Section 7(b)(2), b2-84-FR-03, at 5. BPA, however, did not identify any particular events as uncontrollable events for which costs were allocated according to section 7(g). Kaptur *et al.*, WP-02-E-BPA-56, at 11-12.

Because BPA has not identified any uncontrollable events subject to section 7(g) allocation, it would be inappropriate to select any particular costs to be viewed as uncontrollable events only for the 7(b)(2) rate test. *Id.* Therefore, no adjustment should be made to the Program Case. The IOUs argue that BPA determined that since no costs of uncontrollable events were identified as chargeable to preference customers, there are no uncontrollable events. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 24. The IOUs argue that the costs of PNRR are known and that BPA should acknowledge that the costs of PNRR are the costs of uncontrollable events. *Id.* Simply because the costs of PNRR are known does not mean that they should be treated as the costs of uncontrollable events. The determination of whether the costs of PNRR constitute the costs of uncontrollable events must be made on its merits, as discussed in greater detail in this section.

The IOUs argue that by not characterizing PNRR as the costs of uncontrollable events, "BPA slashed Residential Exchange benefits from \$280 million to \$37 million." IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PL-01, at 22. Contrary to the IOUs' claim, BPA has not "slashed" Residential Exchange benefits by its treatment of this issue. Instead, as discussed in greater detail below, PNRR are clearly not the costs of uncontrollable events. This means that BPA has properly conducted the 7(b)(2) rate test, and the forecasted Residential Exchange benefits are

properly determined. If BPA had not treated this issue properly, by excluding the costs of PNRR from section 7(g) costs in the Program Case, then the Residential Exchange benefits to exchanging utilities would have provided an improper windfall that they did not deserve under the implementation of the 7(b)(2) rate test.

The IOUs argue that BPA's section 7(b)(2) witnesses made no independent review of whether any costs of uncontrollable events existed. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PL-01, at 22. In addition, the IOUs assert that when BPA's section 7(b)(2) panel was asked if they made an independent determination of whether any uncontrollable events should be included in the 7(b)(2) test, they responded "[t]hat's not my job." *Id.*, quoting Tr. 2184. These facts, however, support the fact that BPA conducted the 7(b)(2) rate test in the proper manner. The IOUs' suggestion that the BPA panel's witnesses should have made an "independent review" is misplaced, because it is not the role of the 7(b)(2) staff to determine whether events are uncontrollable. The workgroups responsible for accounting decisions make the determination whether any costs within BPA's COSA are the costs of uncontrollable events. Because the revenue requirement workgroup included no costs of "uncontrollable events" in their cost figures, BPA's section 7(b)(2) panel properly included no such costs in the 7(b)(2) rate test. Tr. 2184. In developing rates and performing the 7(b)(2) rate test, the 7(b)(2) panel uses a series of models called the RAM. The RAM is designed to perform the 7(b)(2) rate test and develop the posted rates using the relevant data for the rate test period. Specialists throughout BPA develop the rate test period data inputs used in the calculation of the 7(b)(2) rate test trigger. Kaptur *et al.*, WP-02-E-BPA-56, at 7. During the cross-examination of BPA's section 7(b)(2) panel, IOU counsel questioned BPA's witnesses as to who in BPA would make the determination of an uncontrollable event. Tr. 2184. The BPA witness replied that "[i]n particular he was on one of the panels, I believe it was DeWolf, *et al.*, I believe that was the Panel." Tr. 2184. In addition, BPA's witness again identified that the revenue requirements experts were responsible for providing information, noting that "We are assuming when our revenue requirements--they'll indicate to us what--if there are any uncontrollable event costs." *Id.*

BPA conducts a regional process for determining the spending levels and program costs for the rate period. In this process there is a comprehensive review of all cost by the regional customers, including parties most affected by the designation of 7(g) costs. Tr. 563. During the cross-examination of BPA's revenue requirements panel, IOU counsel posed questions as to the process BPA uses to develop its revenue requirements.

Q. (Mr. Marshall) Everything is open in a revenue requirement, all costs, whether it be costs of fiber optics, costs of having too many employees, costs of going to Congress to talk about things, all those costs are open to debate before the rate is set and before the charges are made tariffs, correct?

A. (Mr. DeWolf) Right.

Q. (Mr. Marshall) But here some aren't and some are, right?

A. (Mr. DeWolf) No, it isn't correct.

Q. (Mr. Marshall) Some are and some aren't, isn't that correct?

A. (Mr. DeWolf) All of the costs included in the revenue requirement have been subject to public review and discussion, and remain so, outside the 7(i) process. In a cost review process, an extensive regional review process and similarly with issues '98', and similarly with fish costs, developing the Fish and Wildlife Funding principles. So exclusion from the 7(i) process, I mean our basic logic is twofold here. That debate has been held, No. 1; and No. 2, the door remains open for continuing discussions outside the rate proceeding on the wisdom and merits of spending levels.

Tr. 563.

BPA's 7(b)(2) panel is responsible for relying on the data provided by the experts in the area of revenue requirements. In addition, these experts have testified that BPA goes through an extensive regional process to determine not only the level of costs but also the nature of those costs. The revenue requirements experts did not identify any costs of uncontrollable events. In addition, it is clear that BPA would include the cost of an "uncontrollable event" as a "line item in the revenue requirements" if such an event occurred. Tr. 2185.

The IOUs acknowledge that BPA argued that the costs of PNRR are not the costs of uncontrollable events because BPA has not identified any costs as being the costs of uncontrollable events in this rate case. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 23. The IOUs also acknowledged that the 7(b)(2) staff had not identified such costs because it was not their role, and that the 7(b)(2) staff said that it was the role of the revenue requirement panel, and such costs had been considered in a public review process. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 23. The IOUs argue that the implication of the Draft ROD was that the revenue requirements panel did not identify any costs of uncontrollable events because no one in the public review process made such an identification. *Id.* The IOUs argue that the Draft ROD does not explain how the public in that comment process would know that it was incumbent upon them to classify a cost as an uncontrollable event. *Id.* The IOUs argue that it appears that no one was responsible for determining whether or not each cost included in the revenue requirement was uncontrollable. *Id.* The IOUs argue that BPA uses a questionable negative inference to bootstrap a positive statement that PNRR is not an uncontrollable event. *Id.* The IOUs have misunderstood the process that was previously described by BPA. BPA did not say that the revenue requirements panel did not identify any costs of uncontrollable events because no one in the public review process made such an identification. BPA noted that BPA's 7(b)(2) panel is responsible for relying on the data provided by the experts in the area of revenue requirements. In addition to the revenue requirements staff's own expert analysis, BPA goes through an extensive regional process to determine not only the level of costs but also the nature of those costs. The revenue requirements experts, through their review, and through participation in the public review process, did not identify any costs of uncontrollable events. While there is no specific statement regarding how the public would be advised to comment on the uncontrollable nature of costs, any general discussion of a particular cost would necessarily describe the nature of the particular cost. This dialogue would inform BPA's revenue requirements experts, who would then determine whether an uncontrollable event occurred and, if so, incorporate the cost of an "uncontrollable event" as a "line item in the revenue

requirements.” Tr. 2185. While the IOUs argue that it appears that no one was responsible for determining whether or not each cost included in the revenue requirement was uncontrollable, the foregoing discussion has consistently noted that BPA’s revenue requirements experts make such determinations. Contrary to the IOUs’ allegations, BPA has not used a questionable negative inference to bootstrap a positive statement that PNRR is not an uncontrollable event, but rather has examined the issue carefully and concluded that, based on the record and the law, PNRR do not constitute costs of uncontrollable events.

The IOUs argue that the costs of PNRR (over \$127 million a year for five years) are costs of uncontrollable events that should be subtracted from the “program case.” IOU Brief, WP-02-B-AC/GE//IP/MP/PL/PS-01, at 23. The IOUs argue that if risks of future events were controllable there would be no need for a risk reserve. *Id.* First, this issue was addressed in part above where BPA explained why uncontrollable events are not properly viewed as all conceivable events beyond BPA’s control, but rather the discrete and significant events beyond BPA’s control that differ from the continuum of changing conditions that occur in nature, business, and government and are routinely reflected in rate development. In addition, however, BPA’s direct testimony states that “the \$127 million of PNRR is the amount necessary, together with CRAC and other measures, to *mitigate* the wide uncertainties we face to achieve the 88 percent Treasury Payment Probability standard. PNRR, however, is only one component of the total cash flow for risk.” Kaptur *et al.*, WP-02-E-BPA-56, at 12, quoting Lovell *et al.*, WP-02-E-BPA-14, at 13 (emphasis added). During cross-examination of the revenue requirements panel, Dr. Lovell added clarification of the nature of the costs included within PNRR:

In the revenue requirement that we talked about before, for instance, we have some point estimates of various costs that are quite uncertain. The uncertainty around these costs is often brought into the picture in the risk analysis. The plan[ned] net revenue for risk number is calculated during the risk analysis process.

Some of the money that’s collected in the -- through the plan[ned] net revenue for risk entry in the revenue requirement is due to the nature or the risks, not to the sort of costs that one usually thinks of as a cost.

Tr. 568. Dr. Lovell also explained that PNRR is impacted by the fish and wildlife program:

As you know, there is no single fish and wildlife plan at this time. We are faced with uncertainty. In the revenue requirement we have entered deterministic values for some of the financial impacts of the fish and wildlife program because the revenue requirement has to have single point estimate values. The uncertainty over that sort of cost is in the risk analysis, so we do not have a single cost of the fish and wildlife program. So to the extent that the cost can not be captured by a single number, some aspects of the cost are captured only in the risk analysis. In addition, one of the categories of financial impact of the fish and wildlife program is the operational impacts, which are captured in the risk analysis.

Tr. 646.

The point that BPA is making is that the revenue requirement estimates are point value estimates. There is inherent risk in making estimates, which requires a mechanism to buffer the risks so as to ensure an outcome that allows BPA to recover its costs over time. BPA has stated that “[t]he purpose of the plan[ned] net revenues for risk is to increase reserves, but not simply to pay costs, but also to act as a buffer against risks, many of which are uncertainties in costs.” Tr. 569. In addition to the costs defined by Dr. Lovell above, BPA defined the range of uncertainties to include: “operating risk – Hydro and thermal generation performance, California market prices, Southwest gas prices, and generating and non-generating public utility load uncertainty.” Kaptur *et al.*, WP-02-E-BPA-56, at 12. BPA also noted that BPA incurred nonoperating risks, including “fish and wildlife operations and maintenance and capital recovery expenses and other expenses.” *Id.*; Revenue Requirement Study, WP-02-E-BPA-02, at 22-23. PPC agrees with BPA that PNRR is an element of BPA’s risk analysis, which mitigates for a wide yet identified range of uncertainties in factors such as hydro conditions and market prices. PPC Brief, WP-02-B-PP-01, at 70. PPC notes that “[u]ncontrollable events’ is a statutory term referring to discrete events which differ from the continuum of changing events that occur in nature, business and government.” *Id.*, quoting Kaptur *et al.*, WP-02-E-BPA-56, at 9. PPC notes that there is not sufficient evidence for BPA to treat PNRR as an uncontrollable event in the 7(b)(2) rate test calculation. *Id.*

The IOUs argue that BPA’s section 7(b)(2) panel refused to recognize BPA’s costs of risk as costs of uncontrollable events, because they were told that in the 1996 rate case the costs of “uncontrollable events” were recognized only if they were “discrete events not routinely reflected in ratemaking.” IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 23, citing Kaptur *et al.*, WP-02-E-BPA-56, at 11-12. The IOUs have once again mischaracterized BPA’s testimony. BPA’s testimony simply states that “[a]s BPA recognized in its 1996 rate case, ‘uncontrollable events’ is a statutory term that logically refers to discrete events, which differ from the continuum of changing events that occur in nature, business and government.” Kaptur *et al.*, WP-02-E-BPA-56, at 11. This testimony does not state that BPA’s witnesses refused to identify costs of risks as uncontrollable events because they were told something in 1996. The interpretation of the statutory term “uncontrollable events” is a legal matter. While legal advice is generally consistent, and it would be no surprise if legal advice were consistent through any number of rate cases, BPA counsel continually reviews such advice in each rate case to determine if any events would suggest that original legal advice was in error. Part of this review occurs through the evaluation of the parties’ briefs. Having reviewed such briefs, however, BPA believes that its legal interpretation of section 7(b)(2) is correct.

The IOUs argue that the BPA panel did not know whether the cost of an uncontrollable event was intended to indicate the cost of an insurance policy or an insurance reserve to cover the risks of future events--events that could not be controlled. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 23, citing Tr. 2196. BPA has not characterized PNRR as an insurance policy. As stated above, PNRR is a tool to mitigate the risk of a wide range of uncertainty around costs. PNRR is not a mechanism that insures BPA against the cost of potential discrete events that have significant impacts on BPA, such as Mt. Hood erupting and causing severe damage to Bonneville Dam or many other possible events. The development of BPA’s risk models does not include the analysis of events that have little likelihood of occurring, such as the high impact, low probability event of a nuclear war. Though the event would be

considered large and expensive, the assigned probability would be infinitesimal, leading to an expected cost of virtually zero. However, in the case of PNRR, there is the assumption of risk within the continuum of normal business costs, which are routinely included in ratemaking.

The IOUs note that BPA determined that the cost of mitigating a wide range of uncertainties is not the same as the cost of uncontrollable events. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 24. The IOUs argue that BPA confuses the process of dealing with events that are uncontrollable (mitigation) with the events themselves. *Id.* The IOUs argue that if the events were controllable, they would not need mitigation, they would need payment. *Id.* The IOUs argue that it is only because the event is uncontrollable that a mitigation scheme that deals with the (uncontrollable) uncertainties is needed. *Id.* The IOUs argue that risk mitigation is necessary only if events are beyond one's control. *Id.* Again, the IOUs are confusing the ability to perfectly control a cost item with the ability to perfectly forecast the future outcome of that cost item. Obviously, there are millions of cost-related items over which BPA has less than perfect knowledge or control. The amount of heavy load hour power consumed by a specific customer during a specific day in a specific month of a specific year is an example of something which BPA cannot precisely know or perfectly control. However, BPA can make a point forecast of that load and statistically calculate an amount of PNRR that will help mitigate the uncertainty surrounding that point forecast. To characterize the cost of serving that specific load as the cost of an uncontrollable event would be absurd. If the cost of an item is not perfectly known, that lack of perfect knowledge does not, in itself, mean the item is an uncontrollable event. If the event itself is not an uncontrollable event, mitigating the forecast uncertainty around the event's point estimate cannot be the cost of an uncontrollable event.

As noted previously, the IOUs' proposed interpretation makes little sense in the context of the 7(b)(2) rate test. There are millions of "events" that occur daily and which are beyond BPA's control. It is impossible to identify each event that has occurred and which might have some impact on BPA's costs. Congress could not reasonably have intended to impose such an elusive and impractical standard upon BPA. This is confirmed by a review of the statutory context of this term. BPA must interpret the statute in a manner that is consistent with the context in which it is used, that is, the 7(b)(2) rate test. As noted previously, the 7(b)(2) rate test compares PF rates for preference customers under two scenarios: with and without the specific assumptions of section 7(b)(2). This fact suggests that Congress intended the comparison to be between rates that share the same basic costs but for the specific statutory exceptions. For this reason, uncontrollable events should be construed such that they do not exclude costs from the Program Case that are due to conditions that simply vary over time and which typically are reflected in rates. For this reason, uncontrollable events are not properly viewed as all conceivable events beyond BPA's control or perfect knowledge, but rather the discrete and significant events beyond BPA's control that differ from the continuum of changing conditions that occur in nature, business, and government and are routinely reflected in rate development.

To support the argument that PNRR is not an insurance policy against the cost of an uncontrollable event, BPA's 7(b)(2) panel stated during cross-examination that the cost of an "uncontrollable event" such as Mt. Hood erupting would not be taken out of PNRR.

Q. (Mr. Marshall) Let us assume, going back to your hypothetical that Mt. St. Helens or Mt. Hood blows up tomorrow, and you now have 50 years of extra costs from that billion dollars of uncontrollable events. Would any of that come out of PNRR?

A. (Mr. Keep) My understanding of how we would do that is that once the uncontrollable event occurred, the mountain blows up, we decide how we are going to deal with those costs. Let us continue with the hypothetical that instead of continuing in this rate case, since it happened tomorrow, say, that we would do a supplemental. And if we figured out how we were going to deal with those costs, those costs would actually be projections of costs and be known costs and there would not be any risk around them. And my understanding of the risk analysis is that once you have a known event, it ceases to be something that's taken into account by the risk analysis.

Tr. 2191. As illustrated in this testimony, the cost of an "uncontrollable event" would be considered an event that has been recognized and determined to be an event that necessitates a separate line item within the revenue requirement. In addition, given that the cost is known and measurable, it would have very little risk associated with it. The cost of PNRR would therefore not be affected by this event. PPC notes, in addition, that when asked during cross-examination whether money collected through PNRR would cover the cost of an uncontrollable event, BPA's witnesses were clear that: (1) an uncontrollable event identified before or during a rate proceeding would be separately identified as such in the revenue requirement, Tr. 2182-85; and (2) BPA would not necessarily utilize money collected through PNRR to cover the cost of an uncontrollable event, Tr. 2192-93. PPC Brief, WP-02-B-PP-01, at 70.

The IOUs note that BPA stated that "BPA would not necessarily utilize money collected through PNRR to cover the cost of an uncontrollable event," citing Draft ROD, WP-02-A-01, at 13-28. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 25. The IOUs argue that the only basis for this statement appears to be testimony that the huge costs of a hypothetical event such as Mt. Hood erupting would not be taken out of PNRR, but rather BPA would instead probably file a supplemental rate case to deal with those costs, citing Draft ROD, WP-02-A-01, at 13-27. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 25. The IOUs argue that the necessary implication is that the PNRR would be used to pay for all costs of uncontrollable events except for the most enormously expensive of such costs. *Id.* BPA disagrees. The "necessary implication" inferred by the IOUs, that PNRR would be used to pay for all costs of uncontrollable events except for the most enormously expensive of such costs, indicates a lack of understanding about BPA's ratemaking process. As stated above, PNRR does not represent or pay for the costs of uncontrollable events. PNRR is a mechanism for mitigating a wide range of uncertainty around the normal continuum of business costs. Also as discussed above and in other chapters of this ROD, PNRR has the effect of increasing BPA's cash reserves. These increased cash reserves help to mitigate the uncertainties around many of BPA's forecasted ratemaking point estimates, and help to ensure that BPA can achieve the anticipated TPP. PNRR is not a separate fund used to pay for specific types of costs. PNRR is not an insurance policy that will pay off if certain events occur.

The IOUs argue that the intent of Congress was not to protect preference utilities from the costs of events that would have occurred whether the Northwest Power Act was enacted or not; in other words, Congress did not want the costs of uncontrollable events to cut benefits to Residential Exchange customers. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 24; IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 22. The IOUs argue that BPA's witnesses agreed that "an uncontrollable event is by definition something that would have occurred whether the Regional Power Act was enacted or not enacted." *Id.*, quoting Tr. 2210. The IOUs argue that BPA's PNRR are by definition a cost for risks of events that cannot be controlled, and these risks would have occurred whether the Northwest Power Act was enacted or not. *Id.* These IOU arguments are unclear. First, the IOUs state that the intent of Congress was not to protect preference customers from the costs of events that would have occurred whether the Northwest Power Act was enacted or not, arguing that BPA's witnesses agreed that an uncontrollable event would occur whether or not the Northwest Power Act was enacted. *Id.* The IOUs, however, provide no citation to authority in support of this argument. The intent of Congress was to protect preference customers' rates from certain costs as described in section 7(b)(2) of the Northwest Power Act. 16 U.S.C. §839e(b)(2). For these costs, the statute prescribes their treatment, and it does not matter if these costs would have occurred whether or not the Northwest Power Act was enacted. What matters is whether, in a particular rate case, BPA has incurred costs from an uncontrollable event and, if so, whether such costs are treated as section 7(g) costs and are deducted from the Program Case. As BPA has established in previous discussion, the costs of PNRR are not the costs of uncontrollable events. In addition, the IOUs' argument is not persuasive because, in the event that BPA incurred costs for uncontrollable events, public agencies would pay rates that included the allocation of those costs under section 7(g), and exchanging utilities would not pay more than public agencies if these costs were also reflected in the PF Exchange rate.

The IOUs argue that BPA criticized the IOUs' failure to cite authority for the proposition that the intent of Congress was not to protect preference customers' rates from the costs of events that would have occurred whether or not the Northwest Power Act was enacted. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 25. The IOUs argue that the intent is clear from the language and structure of the statute. *Id.* The IOUs, however, continue to cite no authority for this proposition except for the allegation that BPA pointed out that preference customers' rates would be no higher than they would have been had the Northwest Power Act not been enacted. *Id.* The IOUs, however, do not cite an actual statement of BPA on this proposition, but rather cite a Senate report related to the Northwest Power Act. *Id.* The Senate report provides, in part, that "[a] rate test is provided in section 7 to insure that the Administrator's power rate for public bodies and cooperatives entitled to preference and priority under the Bonneville Project Act [are] no greater than would occur in the absence of the regional program established in S. 885." *Id.* The IOUs' argument reflects a common error. While some people refer to the Program Case and the 7(b)(2) Case as the "with Act" and "without Act" cases, this generalization is not accurate. If this were the case there are dozens if not hundreds of provisions of the Northwest Power Act that would have to be deleted from the 7(b)(2) Case. Congress did not do so. Instead, there are five assumptions in section 7(b)(2) that must be used in conducting the rate test. It is not whether the costs of the events would have occurred whether or not the Northwest Power Act was enacted, but rather, as in this case, whether a cost is a cost of an uncontrollable event. The IOUs argue that done correctly, the application of 7(g) lowers the Program Case costs, thereby ensuring that

the rate test does not trigger when the costs of serving preference customers (exclusive of costs of uncontrollable events) in the Program Case are compared with all costs (including uncontrollable events) in the 7(b)(2) Case. *Id.* The IOUs argue that as a result, uncontrollable events that would have occurred regardless of whether the Northwest Power Act was enacted show up as identical costs in both cases, and therefore the difference between the two is zero. *Id.* The IOUs argue that BPA has effectively negated the impact of the exclusion of the costs of uncontrollable events. *Id.* This argument is not persuasive. BPA has conducted the section 7(b)(2) rate test correctly, and BPA has determined that there are no costs that can be defined as the costs of uncontrollable events in this rate proceeding. The IOUs' overly broad and incorrect definition of uncontrollable events as anything that BPA cannot control or have perfect future knowledge about would result in a section 7(b)(2) rate test that could never trigger. Congress would not have provided the PF Preference ratepayers with a rate protection mechanism that would never provide any rate protection.

The IOUs argue that BPA's statement that it does not matter if these costs would have occurred whether or not the Act was passed suggests a fundamental misunderstanding of the rate test because it is those costs and only those costs that are of importance in the test. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 26. BPA disagrees with the IOU argument that costs that would have occurred whether or not the Act was passed are the only costs that are of importance in the test. Fundamentally, the cost of operating and maintaining the Federal hydropower system does not depend on passage of the Northwest Power Act. However, the Northwest Power Act directs how BPA is to define the costs of the system and how rates are to be set to recover those costs. For these costs, the statute prescribes their treatment, and it does not matter if these costs would have occurred whether or not the Northwest Power Act was enacted. What matters is whether, in a particular rate case, BPA has incurred costs from an uncontrollable event and, if so, whether such costs are treated as section 7(g) costs and are deducted from the Program Case. As BPA has established in previous discussion, the costs of PNRR are not the costs of uncontrollable events.

The IOUs also state that Congress did not want the costs of uncontrollable events to cut benefits to Residential Exchange customers. BPA agrees that as a simple matter, if costs of uncontrollable events are removed from the Program Case as section 7(g) costs, this would reduce the likelihood of a section 7(b)(2) trigger and would likely increase exchange benefits, all else being equal. Again, however, the issue is whether or not a particular cost is a cost of an uncontrollable event. As BPA has established in previous discussion, the costs of PNRR are not the costs of uncontrollable events. As noted above, BPA does not dispute that the amounts charged preference customers for the costs of uncontrollable events are to be removed from the Program Case. BPA's interpretation of the Northwest Power Act, however, provides that it is logical to exclude the costs of uncontrollable events as a protection from the 7(b)(2) rate test triggering, because inclusion of the costs of discrete significant events might otherwise bias the rate test for the rate period. In other words, Congress provided protection from the costs of, for example, an act of nature that destroys or damages a resource as opposed to the cost of mitigating risks of costs that are routinely included in the normal course of business and therefore normally included in the course of ratemaking. The IOUs argue that if Congressional intent had been to remove bias, the adjustment to the test would have worked both ways, since bias can be positive or negative. *Id.* This argument is inconsistent with section 7(b)(2) of the

Northwest Power Act. Section 7(b)(2) of the Act refers to “the projected amounts to be charged for firm power for the combined general requirements of public body, cooperative and Federal agency customers, *exclusive* of the amounts charged such customers under subsection (g) of this section . . .” 16 U.S.C. 839e(b)(2) (emphasis added). The Act provides only for a subtraction of 7(g) costs, not the addition of such costs. Therefore, because Congress knew that it was going to permit only the subtraction of such costs, it is logical that Congress excluded the costs of discrete significant events which might otherwise bias the rate test for the rate period.

In summary, the IOUs argue that Congress created the 7(g) adjustments, which make it less likely for the 7(b)(2) exception to rate parity to trigger. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 27. The costs of uncontrollable events are included in 7(g) adjustments. *Id.* The IOUs argue that section 7(b)(2) makes plain that Congress did not want the benefits of Residential Exchange customers to be cut by the costs of uncontrollable events. *Id.* The IOUs also argue that BPA is violating the intent of Congress by refusing to acknowledge that the identified costs of PNRR are costs for events that are beyond BPA’s control. *Id.* In response to these arguments, while the IOUs argue that Congress did not want the benefits of Residential Exchange customers to be cut by the costs of uncontrollable events, the IOUs were not the focus of the section 7(b)(2) rate test. The IOUs fail to recall the background and purpose of the section 7(b)(2) rate test, which is discussed in detail in the introduction to this chapter. The intent of 7(b)(2) is to protect preference customers, not to protect IOUs. Congress recognized that the section 7(b)(2) rate test could reduce or eliminate Residential Exchange benefits. As demonstrated in BPA’s thorough analysis, the costs of PNRR are not the costs of uncontrollable events. BPA is properly implementing the intent of Congress. There are millions of “events” that occur daily and which are beyond BPA’s control. It is impossible to identify each event that has occurred and which might have some impact on BPA’s costs. Congress could not have intended to impose such an elusive and impractical standard upon BPA. This is confirmed by a review of the statutory context of this term. As noted previously, the 7(b)(2) rate test compares PF rates for preference customers under two scenarios: with and without the specific assumptions of section 7(b)(2). This fact suggests that Congress intended the comparison to be between rates that share the same basic costs but for the specific statutory exceptions. For this reason, uncontrollable events should be construed such that they do not exclude costs from the Program Case that are due to conditions that simply vary over time and which typically are reflected in rates. For this reason, uncontrollable events are not properly viewed as all conceivable events beyond BPA’s control, but rather the discrete and significant events beyond BPA’s control that differ from the continuum of changing conditions that occur in nature, business, and government and are routinely reflected in rate development.

### **Decision**

*PNRR are not costs of uncontrollable events and thus should not be excluded from the Program Case.*

### **13.3.2      Terminated Generating Facilities**

#### **Issue**

*Whether the costs associated with terminated generation facilities are uncontrollable events costs to be treated as 7(g) costs in the 7(b)(2) rate test.*

#### **Parties' Positions**

The IOUs argue that the termination of a generating facility constitutes an uncontrollable event, and as such, the costs of the terminated facility should be treated as 7(g) costs in the 7(b)(2) rate test. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 24-27.

#### **BPA's Position**

As noted previously, “uncontrollable events” is a statutory term that logically refers to discrete events that differ from the continuum of changing events that occur in nature, business, and government and that are routinely reflected in ratemaking. Because BPA has not identified any uncontrollable events subject to section 7(g) allocation in its rate proposal, it would be inappropriate to select any particular costs to be viewed as uncontrollable events only for the 7(b)(2) rate test. Kaptur *et al.*, WP-02-E-BPA-56, at 11. While it is possible, in the proper circumstances, that the cost of an uncontrollable event could include the cost of a terminated generating facility, a deliberate, reasoned, discretionary decision to terminate a generating facility is not an uncontrollable event. Therefore, the cost of a terminated facility in such circumstances should not be considered a section 7(g) cost for purposes of the 7(b)(2) test, and no amount should be excluded from the Program Case for the cost of uncontrollable events.

#### **Evaluation of Positions**

First, it is significant that the IOUs did not file any testimony in this hearing supporting a proposal to treat the costs of terminated plants as the costs of uncontrollable events. Therefore, there is very little evidence in the record to support their proposal. The IOUs argue that while BPA noted that no witnesses from the IOUs testified whether the costs of terminated generating facilities should be included as costs of uncontrollable events, there was no need for such testimony because BPA documents clearly admitted the proposition. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 27. While the IOUs claim that there was no need for such testimony, the IOUs' failure to even mention this issue in their testimony has severely limited any record support for their arguments.

Similarly, BPA has reviewed its previous rate case RODs and no party has ever, in the history of implementation of the 7(b)(2) rate test, argued that the costs of terminated plants are costs of uncontrollable events. The IOUs cite BPA's cross-examination testimony for the proposition that including the costs of terminated nuclear plants as an uncontrollable event would greatly reduce the 7(b)(2) rate test trigger. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 25. These statements, of course, prove little. The issue is whether a particular termination of a generating

facility is an uncontrollable event, not whether any event, regardless of what it is, would have an effect on the section 7(b)(2) rate trigger.

The IOUs argue that BPA has admitted in its own general contract provisions that the costs of terminated generating plants are required to be defined as costs of “uncontrollable events.” IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 25-26. The IOUs cite section J of the 1981 General Contract Provisions (GCPs) entitled “Allocation of certain section 7(g) Costs.” Actually this is section 8(j) of the GCPs, which falls under section 8 of the GCPs, entitled “Equitable Adjustment of Rates.” Most of BPA’s power sales contracts were executed in 1981 and included the GCPs as an exhibit. The 1981 power sales contracts terminate on July 1, 2001. This date precedes the effective date of BPA’s 2002 wholesale power rates, which will go into effect on October 1, 2001. Section 8 of the GCPs, including section 8(j), governs only the development of rates that will be in effect during the term of the 1981 power sales contracts, that is, the rates that would apply to the sales made under those contracts. Those sales terminate on July 1, 2001. Clearly, the rates being developed in the proceeding will not be in effect during the term of the 1981 contracts, and section 8 of the GCPs does not apply. To interpret this provision otherwise would preclude BPA from revising its rates until the current rates expired, leaving BPA no time to conduct a hearing to establish new rates before the new contract period had begun and requiring that BPA have no rates in effect until the hearing was completed. This would truly be an absurd result. Even assuming, *arguendo*, that the provisions were to be applicable, section 8(j) does not establish that all terminated generating facility costs are costs of uncontrollable events. GCP section 8(j) states:

(j) Allocation of Certain Section 7(g) Costs. Costs of uncontrollable events, including but not limited to costs of a terminated generating facility and costs of experimental resources, in excess of the cost of cost effective resources, shall be allocated pursuant to section 7(g) of PL-96-501 and shall be allocated among Customers on a uniform per kW or kWh basis . . .

Cross-Examination Exh. WP-02-E-PL-16, at 136. The quoted language refers to “[c]osts of *uncontrollable events*, including but not limited to costs of a terminated generating facility . . .” The first requirement of this provision is that the event be an “uncontrollable event.” BPA does not dispute that, during the time when this provision was actually in effect, it was possible for the costs of a terminated generating facility to be included in the costs of an uncontrollable event. This would occur where the termination of the facility was a result of an uncontrollable event. This is the statutory requirement of section 7(g) of the Northwest Power Act. 16 U.S.C. §839e(g). This requires review of the particular terminated generating facility to determine if its termination was a reasoned discretionary decision or if it was the result of an uncontrollable event, such as an earthquake, a flood, a terrorist act, and so on. The IOUs presented no evidence in the rate hearing that the termination of the cited nuclear projects was the result of an uncontrollable event. Clearly, the termination of a generating facility that is the result of a reasoned decisionmaking process that has taken place over a period of time, and where the decision could have been decided either way, cannot be considered an uncontrollable event. In deciding whether to terminate a generating facility, the owner must receive and analyze information about many factors relating to termination. How much would it cost? Is there a market for the power above cost? What would be the decommissioning costs? These

many questions must be weighed by the decisionmaker. The decision that is informed by such analyses where there is not a required termination, but rather a discretionary decision to do so, is not uncontrollable. Uncontrollable events can cause the termination of a generating facility. The termination of a generating facility, however, is not an uncontrollable event unless the termination is caused by an uncontrollable event.

The IOUs note BPA's position that a provision of the 1981 GCPs which permitted terminated generating plants to be uncontrollable events in the proper circumstances is not dispositive, because the GCPs will expire on July 1, 2001, before the new rates take effect. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 29. The IOUs argue that this does not provide a rational basis for BPA's change in position. *Id.* The IOUs' argument, however, is not persuasive, because BPA has not changed its position on this issue. The quoted language refers to "[c]osts of uncontrollable events, including but not limited to costs of a terminated generating facility . . ." The first requirement of this provision is that the event be an "uncontrollable event." As noted above, BPA does not dispute that, during the time when this provision was actually in effect, as well as currently, it was possible for the costs of a terminated generating facility to be included in the costs of an uncontrollable event. This would occur where the termination of the facility was a result of an uncontrollable event.

The DSIs argue that BPA stated that GCP 8(j) is irrelevant to the meaning of uncontrollable forces in section 7(b)(2) of the Northwest Power Act. DSI Brief, WP-02-R-DS-01, at 27. This is incorrect. BPA did not say that GCP section 8(j) was irrelevant, rather that it did not govern the development of BPA's current rates. The DSIs argue that section 8 of the GCPs largely reflects the contemporaneous understanding of the Northwest parties, including BPA, that had recently completed negotiations regarding how the section 7 rate directives would be applied. *Id.* The DSIs, however, did not address this proposition in testimony and have cited no record support for this proposition. Nevertheless, as noted previously, the provision provides that the costs of a terminated generating facility can be included as the costs of an uncontrollable event where the termination of the facility was a result of an uncontrollable event. The DSIs argue that regional parties at that time feared the termination of one or more nuclear plants prior to completion. *Id.* Again, the DSIs did not address this proposition in testimony and have cited no record support for this proposition. The DSIs argue that they believe that GCP section 8(j) demonstrates that parties to the GCPs expected the costs of plants terminated prior to commercial operations were to be treated as costs of uncontrollable events under the rate directives. *Id.* This argument proves too much. If as the DSIs assert, regional parties feared the termination of one or more nuclear plants, treating the costs of such plants as the costs of uncontrollable events would have made the section 7(b)(2) rate test meaningless. BPA's preference customers, who are entitled to rate protection under section 7(b)(2), certainly would not have agreed to such a provision. The DSIs argue that they do not believe that GCP section 8(j) was intended to address the retirement of operating power plants, so the costs of Trojan and Hanford would be costs of uncontrollable events only if their premature retirement were caused by uncontrollable events. *Id.* at 28. In summary, the DSIs argue that it would be incorrect to suggest that GCP section 8(j) would become irrelevant when all the 1981 contracts have expired. *Id.* As noted above, BPA does not believe that GCP section 8(j) is irrelevant, but it does not apply to current rate development and, in any event, would support the proposition that the costs of a terminated generating facility can

be included as the costs of an uncontrollable event where the termination of the facility was a result of an uncontrollable event, as BPA has previously defined.

The IOUs argue that BPA's panel testified that there have been terminated generating facilities, referring to the termination of "Trojan, Hanford, WNP-1, and WNP-3." *Id.* at 26, citing Tr. 2202. The IOUs argue that a BPA witness then said he did not know if Trojan and Hanford were terminated; "They're just shut down," Tr. 2202. In actuality, the witness stated:

Q. Have there been any nuclear plant terminations in which BPA has had an interest?

A. (Mr. Keep) My understanding is that there has been.

Q. Which ones are those?

A. Trojan, Hanford, WNP-1 and WNP-3, I believe – wait a minute. I do not know if Hanford and Trojan were terminated. They are just shut down. I am not sure what you mean by terminated, I guess.

In addition, the BPA witness stated:

Q. Without further definition of terminated generating facilities, you started to identify several nuclear plants that you believe had been terminated and which BPA has an interest, including WNP-1 and WNP-3, is that right?

A. (Mr. Keep) It is correct that I identified--I started to identify those plants. I am still not sure, particularly, if terminated in terms of--since I gave those four plants, two of them were actually up and operating. If terminated would mean the same thing under that case versus 2, that never--if you had never, ever said that--maybe you can not terminate something until it actually gets fired up and actually produces. So I am confused about the term "terminated," and I will end my answer with that statement of my confusion.

Tr. 2204.

In their initial brief, the IOUs argue that the cost of just two of the terminated generating facilities, WNP-1 and WNP-3, is \$943,933,000 for FY 2002-2006, as shown in Cross-Examination Exhibit WP-02-E-PS-11. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 24. The cross-examination exhibit referenced was prepared by the IOUs, not prepared by BPA. The document was not presented by the IOUs in their direct testimony, where all other parties would have had an opportunity to review and respond to the document, including cross-examination of the witnesses sponsoring the document. While the IOUs cite the transcript as support for this proposition, Tr. 2205, this citation does not support their claim. The BPA witnesses did not say that the IOUs' figures were accurate. Tr. 2205. The IOUs then argue that the only reason the BPA panel could give for failing to include these costs was that "it didn't fit our perception--you have to understand our perception of an uncontrollable event is a volcano

going off.” IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 26, citing Tr. 2206. Once again, the IOUs have mischaracterized BPA’s testimony. The IOUs imply that the only type of uncontrollable event in BPA’s eyes is a volcano. This, of course, is absurd. As noted previously, uncontrollable events is a statutory term that logically refers to discrete events which differ from the continuum of changing events that occur in nature, business, and government and are routinely reflected in ratemaking. This encompasses many, many events other than “a volcano going off.” With regard to the foregoing issues, the IOUs have been quite selective in their use of BPA’s cross-examination testimony. The questions and answers during cross-examination demonstrate the actual exchange that took place:

Q. Now, turn to Cross-Examination Exhibit WP-02-E-PS-11, the last page.  
That’s a different stack.

A. (Mr. Keep) Okay. We did divide the piles into two piles. Yes, I have it.

Q. Do you see that chart there? It is labeled costs of terminated facilities, included in BPA’s proposal [reference is to table prepared by PSE, not BPA].

A. (Mr. Keep) Well, I do not really agree with the term – like I said, I am not sure.

Q. I am just asking if you see it.

A. (Mr. Keep) I see it.

Q. Very good. Now, look at the line that has a large bracket around it, with the figure 943 million – 943,933,000. Do you see that?

A. (Mr. Keep) Yes.

Q. Now, have you reviewed this document before today?

A. (Mr. Keep) I have seen this table before today.

Q. And you have reviewed it?

A. (Mr. Keep) In my opinion, I have reviewed it, yes.

Q. Did you talk to anybody about it?

A. (Mr. Keep) I talked to Mr. Doubleday and Mr. Kaptur about it.

Q. What did you talk about?

A. (Mr. Keep) That we thought it was a very nice-looking table.

A. (Mr. Doubleday) And also part of the conversation was the fact that in our understanding the termination of facilities was at the administrator's discretion, and it was hard for us, personally, and with our understanding of what an uncontrollable event was, that a recent decision that took place over time and could have gone either way, could be described as an uncontrollable event.

A. (Mr. Keep) Could not be described.

A. (Mr. Doubleday) Well, yeah. That describing a decision that was made over time and could have gone either way could be--it did not fit our perception--you have to understand our perception of an uncontrollable event is a volcano going off. The administrator's decision to terminate a generating facility just didn't rise to that level to us.

A. (Mr. Keep) Especially when there is regional debate on whether it should be terminated. Seems to me that given the outcome of that debate on any one of those particular projects, they may or may not have been terminated.

Tr. at 2205-06. From the testimony above, it is clear that the 7(b)(2) rate test panel's understanding of what constituted an uncontrollable event did not include a regional debate and discretionary administrative decision that resulted in the termination of a generating facility.

The IOUs argue that there is no reason to believe Congress limited the costs of uncontrollable events to a volcano going off. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 27. As discussed above, the IOUs have mischaracterized BPA's testimony. BPA did not say that Congress limited uncontrollable events to a volcano going off. A volcano was a single example of many, many events that could comprise uncontrollable events. The IOUs argue that Congress intended to encompass the costs of all uncontrollable events. *Id.* This is not true. The analysis of whether there are costs of "uncontrollable events" that should be excluded from the Program Case must begin with an interpretation of this statutory term. The IOUs argue that the word "event" is defined as "something that happens," which is not limited in any manner whatsoever and applies to any occurrence that is beyond BPA's control. IOU Brief, WP-02-B-AC/GE/IP/MP//PL/PS-01, at 23, n. 62. This interpretation makes little sense in the context of the 7(b)(2) rate test. There are millions of "events" that occur daily and which are beyond BPA's control. It is impossible to identify each event that has occurred and which might have some impact on BPA's costs. Congress could not reasonably have intended to impose such an elusive and impractical standard upon BPA. This is confirmed by a review of the statutory context of this term. BPA must interpret the statute in a manner that is consistent with the context in which it is used, that is, the 7(b)(2) rate test. As noted previously, the 7(b)(2) rate test compares PF rates for preference customers under two scenarios: with and without the specific assumptions of section 7(b)(2). This fact suggests that Congress intended the comparison to be between rates that share the same basic costs but for the specific statutory exceptions. For this reason, uncontrollable events should be construed such that it does not exclude costs from the Program Case that are due to conditions that simply vary over time and which typically are reflected in rates. For this reason, uncontrollable events are not properly viewed as all

conceivable events beyond BPA's control, but rather the discrete and significant events beyond BPA's control that differ from the continuum of changing conditions that occur in nature, business, and government and are routinely reflected in rate development. The decision whether to terminate a generating resource, where the decision could go either way, cannot be defined as uncontrollable. Therefore, there is every reason to believe that Congress would not define such a discretionary, deliberative decisionmaking process as an "uncontrollable event."

The termination of WNP-1 and WNP-3 provide evidence that a reasoned process of deliberation leading to the discretionary termination of a generating facility is not an uncontrollable event. BPA issued a ROD regarding the termination of WNP-1 and WNP-3 ("WNP-1 and WNP-3 ROD"). In that ROD, BPA conducted a thorough analysis of numerous factors relating to the discretionary decision of whether the plants should be terminated. *Id.* BPA listed a number of decision factors. *Id.* at 6. These factors included how completing WNP-1 and WNP-3 would affect BPA's competitiveness, *id.* at 6-7; BPA's need for additional resources, *id.* at 7-8; how WNP-1 and WNP-3 compare to BPA's other resource alternatives, *id.* at 8-10; and the advantages and risks of WNP-1 and WNP-3 and their alternatives, *id.* at 11-13. BPA also reviewed the alternate uses of WNP-1 and WNP-3. *Id.* at 13-14. In summary, the Administrator stated:

On balance, it is my determination that based on the totality of factors, on the assumptions regarding the future of the plants, and on other circumstances, neither the long-term continued preservation of WNP-1 and -3 or the ultimate completion of the projects under the terms of the existing agreements is in the best interest of BPA and the region's ratepayers. Consistent with this determination, I find that the plants are not capable of producing energy consistent with prudent utility practice.

*Id.* at 14. Clearly, the decision to terminate WNP-1 and WNP-3 was a carefully reasoned discretionary decision in which the Administrator clearly explained the reasons for that discretionary decision. A decision of this nature is not an uncontrollable event. Indeed, this decision would be best characterized as a controllable event: a discretionary decision made by the Administrator.

The termination of PGE's Trojan Nuclear Power Plant also provides evidence that a reasoned process of deliberation leading to the termination of a generating facility is not an uncontrollable event. Within its rate filing (UE-88) before the OPUC, PGE proved that the closure of Trojan was a "Least Cost Decision." OPUC Order No. 95-322. The company cited that "during its least-cost planning process in 1992, PGE weighed Trojan's continued viability. Among other things, PGE considered the cost of replacing the four steam generators in 1996, the loss of generation that would occur until they were replaced, and the replacement power costs such a loss would entail. In its 1992 Least-Cost Plan (LCP), PGE decided to close Trojan in 1996." *Id.* at 25. PGE proposed an earlier closure date in PGE's February 1993 update to its LCP. The foregoing shows PGE's reasoned analysis for the discretionary termination of the plant.

With regard to Hanford, there is no evidence in the record demonstrating that DOE's decision regarding its plutonium reactor was an uncontrollable event. Therefore, BPA has also concluded that this was a discretionary decision.

The IOUs note BPA's argument that terminating a generating facility is an uncontrollable event only if the termination is caused by an uncontrollable event such as an earthquake, flood, terrorist act, or other such events. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 29. Similarly, BPA noted that the shutdown of several plants in Washington was a planned controlled event that was part of a deliberative process which is characterized by or results from consideration of relevant factors. *Id.* The IOUs argue that this distinction is not rational and depends on drawing an arbitrary temporal line between cause and effect. *Id.* The IOUs argue that once the plants lost billions of dollars, contrary to everyone's intentions and expectations, BPA decided it was prudent to mothball the projects. *Id.* The IOUs, however, filed no testimony on these issues and have cited no record support for these factual allegations. The IOUs argue that the fact that BPA engaged in a deliberative process regarding how to address these uncontrollable events once they occurred does not change the fact that the costs were the result of uncontrollable events. *Id.* The IOUs, however, have not established that such costs were the costs of uncontrollable events. Where a decision to terminate a plant can go either way, the termination is clearly not an uncontrollable event. The IOUs argue that BPA would engage in the same deliberative processes following damage to a generating facility caused by earthquake, flood, or terrorist act to determine whether to terminate or try to repair or replace the facility and plan a course of action for implementing such decisions, yet BPA agrees that in such a case, if it decided to terminate a facility it would be considered the cost of an uncontrollable event. *Id.* This argument is not persuasive, because the IOUs focus solely on the conduct of a deliberative process as BPA's basis for concluding that certain costs were not the costs of uncontrollable events. It is not simply the conduct of a deliberative process but the circumstance in which a decision to terminate could go either way. Where a decisionmaker has alternative courses of action that do not require termination, termination is not an uncontrollable event, it is a controllable event.

As the IOUs describe above, deliberative processes can be associated with uncontrollable events. *Id.* However, BPA makes a distinction between a deliberative process that is associated with an uncontrollable event and a deliberative process that is not associated with an uncontrollable event. On the one hand, a deliberative process can be used to assess possible actions following an uncontrollable event, such as damage to a generating facility caused by earthquake, flood, or terrorist act. This damage is the cost of an uncontrollable event. On the other hand, a deliberative process can be used to assess the continuum of changing conditions that occur in nature, business, and government and are routinely reflected in rate development. In the first example, an individual uncontrollable event precipitated the deliberative process. In the second example, typical business review resulted in a decision to take a particular direction. Clearly, the termination of WNP-1 and -3 were one option among other viable options, and the Administrator's discretionary decision was not an uncontrollable event.

The IOUs argue that Congress certainly had no intent to protect preference utilities from the costs of terminated nuclear plants. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 7; IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 30. The IOUs argue that Congress did

not intend to single out residential customers of IOUs to bear the costs of these terminated nuclear plants--which would have happened even without the Northwest Power Act. *Id.* These arguments are misplaced. Preference customers are not protected from the costs of terminated generating plants. Assuming that WNP-1 and WNP-3 are terminated generating plants, the costs of such plants are defined under the Northwest Power Act, 16 U.S.C. §839a(10), and in the rate case as FBS costs. As such, these costs are used in the calculation of rates in both the Program Case and the 7(b)(2) Case of the 7(b)(2) rate test. Since these costs are in both the Program and 7(b)(2) cases of the rate test, preference customers are not protected from these costs. Since these costs are in both the Program and 7(b)(2) cases of the rate test, residential customers of IOUs are not singled out to bear these costs. The IOUs' arguments regarding Congressional intent are flawed for additional reasons. Using the overly broad IOU definition of "uncontrollable events," where the costs of every imaginable event that BPA cannot control are considered costs of uncontrollable events, would render the 7(b)(2) rate test superfluous.

The IOUs argue that no one planned for WNP-1 and WNP-3 to fail, and it was an uncontrollable event. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 30. The IOUs, however, have not established that WNP-1 and WNP-3 "failed," or that the alleged "failure" of WNP-1 and WNP-3 was an uncontrollable event. Indeed, the IOUs filed no testimony on this issue. Contrary to the IOUs' claims, as established above, it was a circumstance in which the Administrator had viable options to continue or terminate the plants and made a discretionary decision to terminate. This was hardly uncontrollable. Furthermore, there was no discrete event that caused the termination of WNP-1 and WNP-3. The IOUs argue that treatment of these costs as though they were not due to uncontrollable events is arbitrary and capricious. *Id.* To the contrary, as demonstrated by the discussion in this section, this treatment is reasonable and supported by the record and applicable law.

Congress recognized that there were ratemaking conditions when the 7(b)(2) rate test would likely trigger. Report of Senate Committee on Energy and Natural Resources, S. Rep. No. 96-272, 96th Cong., 1st Sess. 62 (1980). One of these conditions is when DSI loads are reduced relative to preference loads. *Id.* This happened first in the 1996 rate case and continues in this rate case. Another condition that makes the 7(b)(2) rate test more likely to trigger is when IOU exchange power costs become more expensive relative to BPA power costs. *Id.* This happened first in the 1996 rate case and continues in this rate case. Congress would not have defined "uncontrollable events" so broadly that ratemaking conditions that Congress itself expected to result in preference customer rate protection do not provide that protection.

In summary, the IOUs argue that including terminated plant costs as uncontrollable events would greatly reduce the section 7(b)(2) trigger amount and increase Residential Exchange benefits. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 27; IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 28. This, however, is not the test that BPA must apply in conducting the 7(b)(2) rate test. BPA must determine whether specific terminated plant costs are the costs intended by Congress to constitute the costs of uncontrollable events. The terminated plant costs cited by the IOUs do not pass this test. While the IOUs argue that excluding these costs from the 7(b)(2) test is arbitrary, capricious, and a violation of law, the foregoing discussion establishes that BPA's decisions are well reasoned, supported by the record and legal analysis, and are consistent with the law.

## **Decision**

*The costs of the cited terminated generating resources are not costs of uncontrollable events and thus are not treated as 7(g) costs in the 7(b)(2) rate test.*

### **13.4        7(b)(2) Resources**

#### **13.4.1      FBS Resources**

## **Issue**

*Whether BPA has sufficient FBS resources in the 7(b)(2) Case to meet 7(b)(2) customer loads.*

## **Parties' Positions**

The DSIs argue that BPA initially stated that in the 7(b)(2) Case that “[a]dditional resources [beyond FBS] were needed to serve the 7(b)(2) customers’ loads from the start of the test period.” DSI Brief, WP-02-B-DS-01, at 69, citing Kaptur *et al.*, WP-02-E-BPA-34, at 12. The DSIs state that BPA subsequently revised this position due to further review of BPA’s 7(b)(2) Rate Test Study Documentation, concluding that FBS resources exceed the 7(b)(2) customers’ loads in all years. DSI Brief, WP-02-B-DS-01, at 69.

## **BPA’s Position**

BPA agrees with the DSIs that additional resources in excess of the FBS are not needed in the 7(b)(2) Case because the FBS is sufficient to meet 7(b)(2) customers’ loads. Kaptur *et al.*, WP-02-E-BPA-56, at 18.

## **Evaluation of Positions**

The DSIs argue that, in the 7(b)(2) Case, BPA must assume that the 7(b)(2) customers’ loads “were served during such five-year period, with Federal base system [“FBS”] resources not obligated to other entities under contracts . . .” DSI Brief, WP-02-B-DS-01, at 69, citing section 7(b)(2) of the Northwest Power Act, 16 U.S.C. §839e(b)(2). The DSIs argue that if these FBS resources were insufficient to meet the 7(b)(2) customers’ loads, then BPA may include the costs of certain, statutorily specified resources in the 7(b)(2) Case costs. DSI Brief, WP-02-B-DS-01, at 69. The DSIs argued in their direct case that additional resources in excess of FBS resources are not needed to serve 7(b)(2) customers’ loads from the start of the test period, as evidenced by the size of the FBS (8,766 aMW), which exceeds the 7(b)(2) loads (from 5,423 aMW to 7,191 aMW). Schoenbeck *et al.*, WP-02-E-DS/AL/VN-04(E1), at 11. BPA agrees that additional resources are not needed, because the FBS is sufficient to meet the loads of 7(b)(2) customers in the 7(b)(2) case. Kaptur *et al.*, WP-02-E-BPA-56, at 18.

## **Decision**

*FBS resources are sufficient to meet the loads of 7(b)(2) customers in the 7(b)(2) Case, and BPA will not need additional resources to meet such loads.*

### **13.4.2      7(b)(2) Case Load/Resource Balance**

#### **Issue**

*Whether BPA should establish a new load/resource balance in the 7(b)(2) Case to reflect the fact that resources from the 7(b)(2) resource stack are not needed to serve 7(b)(2) customers' loads and cannot be used to serve FPS contract loads.*

#### **Parties' Positions**

PPC notes that BPA used the same size FBS in modeling the 7(b)(2) Case as was used to model the Program Case. PPC Brief, WP-02-B-PP-01, at 73-74. PPC notes that there are increased industrial loads in the 7(b)(2) Case. *Id.* PPC notes that in the 7(b)(2) Case, the FBS is sufficient to serve 7(b)(2) customers' (public body and cooperative customers') loads. *Id.* PPC also notes that in the 7(b)(2) Case, the FBS is not sufficient to serve all of the FPS sales served in the Program Case. *Id.* Therefore, it is appropriate to serve surplus sales in a particular order. *Id.*

#### **BPA's Position**

BPA agrees with PPC that in the 7(b)(2) Case, the FBS is not sufficient to serve all of the FPS sales served in the Program Case. Therefore, BPA must determine which FPS sales served in the Program Case will also be served in the 7(b)(2) Case. PPC Cross-Examination Exhibit, WP-02-E-PP-41. This determination requires that a separate loads and resources balance be performed in the 7(b)(2) Case.

#### **Evaluation of Positions**

The PPC states that BPA concluded that the FBS is sufficient to serve 7(b)(2) customers' loads, largely because pre-existing contracts are returning. PPC Brief, WP-02-B-PP-01, at 74. Thereafter, BPA proposed to serve surplus sales and to do so in a particular order, as provided in a BPA data response that describes an approach for determining which surplus power sales served in the Program Case would be served in the 7(b)(2) Case. *Id.*; PPC Cross-Examination Exhibit, WP-02-E-PP-41. The methodology outlined in Exhibit WP-02-E-PP-41 is a guide for modeling FPS sales in the 7(b)(2) Case, as described below.

[T]he following is an approach for determining which FPS sales served in the Program Case would be served in the 7(b)(2) Case.

The Program Case includes revenues associated with four types of FPS sales. BPA has existing contracts for three types of FPS sales: (1) FPS pre-Subscription contracts in the PNW; (2) FPS contracts at other than fully allocated cost in the PNW; and (3) FPS contracts at other than fully allocated cost in the Pacific

Southwest. The fourth type is a forecasted sale of FPS power to an as yet undetermined set of buyers.

When determining which FPS sales to model in the 7(b)(2) Case, BPA would consider Program Case FPS sales with existing contracts to be served first. In addition, within those FPS sales with existing contracts, sales to the PNW would be served first. Using these criteria, FPS sales served in the 7(b)(2) Case would be chosen in the following order: (1) FPS pre-subscription contracts in the PNW; (2) FPS contracts at other than fully allocated cost in the PNW; (3) FPS contracts at other than fully allocated cost in the PSW (including Excess Federal Power); and (4) forecasted sales of FPS power to an as yet undetermined set of buyers.

Although no analysis has been performed, BPA believes all of the first two types of Program Case FPS sales mentioned above would be served in the 7(b)(2) Case. Also, a portion of the third type and none of the fourth type would be served. The reasons for this likely outcome include: (1) the DSI load is proposed to be about 819 aMW greater in the final 7(b)(2) Case than in the 7(b)(2) Case, *see* Kaptur *et al.*, WP-02-E-BPA-56, at 18, line 8; (2) the size of the FBS resource is the same in both the Program and 7(b)(2) Cases because contractual obligations that might have reduced the size of the 7(b)(2) Case FBS no longer exist, *see* Section 7(b)(2) Implementation Methodology ROD, b-2-84-F-02, at 42; and (3) resources from the 7(b)(2) Case resource stack would not be used to serve FPS sales, *see* Kaptur, *et al.*, WP-02-E-BPA-56, at 21, lines 13-15.

The 7(b)(2) Implementation Methodology directs BPA to use ratemaking methodologies and input data in the out-years of the 7(b)(2) rate test period (FY 2007-FY 2010) that are consistent with those used for the rate case period (FY 2002-FY 2006). *See* 7(b)(2) Implementation Methodology ROD, b-2-84-F-02, at 39-40. Accordingly, FPS contracted-for sales that are in force in the first year of the 7(b)(2) Case would continue to be in force for the entire rate test period, unless the contract itself expires before that time. Also, FPS contracted-for sales that are not in force in the first year of the 7(b)(2) Case, due to insufficient FBS resources to serve them, would not be used for any year of the rate test period.

The 7(b)(2) Implementation Methodology anticipated that the Surplus Firm and Nonfirm sales could be considerably different in the Program and 7(b)(2) Cases. *See* 7(b)(2) Implementation Methodology ROD, b-2-84-F-02, at 43 and 44. Any additional firm surplus in the 2002 7(b)(2) Case would be sold at a market price.

PPC Cross-Examination Exhibit, WP-02-E-PP-41.

In implementing this methodology, BPA determined that, obviously, first year FPS sales do not ensure sales for the five-year rate period. Therefore, the FPS contracts in force during each of the first five years of the 7(b)(2) rate test period will remain in force during the entire nine-year rate test period, and those contracts not served by BPA power during each of the first five years,

due to insufficient FBS resources to serve them, will also not be served in the last four years of the nine-year rate test period. The first two types of FPS contracted-for sales mentioned above are fully served, along with the EFP portion of the third type of sales. EFP sales are subject to seven years' notice for termination. None of the fourth type of FPS sales is served in the 7(b)(2) Case.

### **Decision**

*For the final proposal BPA is utilizing the methodology in PPC Cross-Examination Exhibit WP-02-E-PP-41, as described above, to model FPS load in the 7(b)(2) Case and establish a new load/resource balance for the 7(b)(2) Case.*

## **13.5      Mid-Columbia Resources**

### **Issue**

*Whether BPA should include Mid-Columbia resources in the 7(b)(2) Case resource stack.*

### **Parties' Positions**

The DSIs argue that BPA cannot lawfully include Mid-Columbia resources serving regional loads in the 7(b)(2) Case resource stack. DSI Brief, WP-02-B-DS-01, at 72-75. The DSIs argue that they do not contest BPA's conclusion that the Mid-Columbia issue is moot in this case if BPA does not use resources from the resource stack to serve 7(b)(2) customers' loads. DSI Ex. Brief, WP-02-R-DS-01, at 28. The IOUs argue that BPA relied on BPA's 1996 rate case as precedent for purposes of the Mid-Columbia resources and that such use is prohibited because of a "no precedent" clause in a settlement agreement. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 102-103. The PPC argues that the Northwest Power Act permits BPA to include the Mid-Columbia resources in the 7(b)(2) Case resource stack and that BPA has properly priced such resources. PPC Brief, WP-02-B-PP-01, at 71-72.

### **BPA's Position**

BPA believes that the Northwest Power Act permits BPA to include the Mid-Columbia resources in the 7(b)(2) Case resource stack. Kaptur *et al.*, WP-02-E-BPA-34, at 13-15; Kaptur *et al.*, WP-02-E-BPA-56, at 22-27. BPA believes that the Mid-Columbia resources have been properly included in the resource stack and that BPA has properly priced such resources. *Id.*

### **Evaluation of Positions**

In the initial proposal, BPA proposed to use resources from the resource stack in the 7(b)(2) Case, which included Mid-Columbia resources, to meet specified loads. Kaptur *et al.*, WP-02-E-BPA-34, at 12. In BPA's rebuttal testimony, however, BPA recognized that additional resources in excess of the FBS were not needed to meet 7(b)(2) customers' loads; therefore, it was unnecessary to use any resources from the 7(b)(2) Case resource stack in conducting the 7(b)(2) rate test. Kaptur *et al.*, WP-02-E-BPA-56, at 18-19. Because BPA did not propose to

use resources from the 7(b)(2) Case resource stack, including the Mid-Columbia resources, in conducting the 7(b)(2) rate test, this issue would not affect the development of BPA's wholesale power rates in this proceeding and need not be addressed at this time.

### **Decision**

*The issue of whether BPA should include Mid-Columbia resources in the 7(b)(2) Case resource stack is moot, because BPA will not use any resources from the resource stack, including Mid-Columbia resources, to meet 7(b)(2) customers' loads.*

## **13.6      Demand Elasticity**

### **Issue**

*Whether BPA should increase the amount of "within and adjacent" DSI loads above what was included in the initial proposal 7(b)(2) Case.*

### **Parties' Positions**

The IOUs urged BPA to increase the "within and adjacent" loads in the 7(b)(2) Case above the amount in BPA's initial proposal, based upon the theory that DSI loads would naturally increase in the 7(b)(2) Case as a result of elasticity of demand, which they argue is a "natural consequence" of the statutory assumptions. Hoff *et al.*, WP-02-E-AC/GE/IP/MP/PL/PS-03, at 28-29.

The DSIs argued that section 7(b)(2)(A) of the Northwest Power Act is not intended to augment the 7(b)(2) public and cooperative loads by arbitrarily transferring to utilities in the 7(b)(2) Case DSI loads that are in existence but not served by BPA in the Program Case. DSI Brief, WP-02-B-DS-01, at 69-72; DSI Ex. Brief, WP-02-R-DS-01, at 28-30.

### **BPA's Position**

BPA agrees with the IOUs that the "within and adjacent" DSI loads in the 7(b)(2) Case should be increased beyond the amount used in BPA's proposal. Kaptur *et al.*, WP-02-E-BPA-56, at 17-18.

### **Evaluation of Positions**

During the hearing, the IOUs asked BPA to increase the "within and adjacent" loads in the 7(b)(2) Case above the amount in BPA's proposal, arguing that DSI loads would naturally increase in the 7(b)(2) Case as a result of elasticity of demand, which is a "natural consequence of the Northwest Power Act's section 7(b)(2) assumptions." Hoff *et al.*, WP-02-E-AC/GE/IP/MP/PL/PS-03, at 28-29. In its rebuttal testimony, BPA staff agreed with the IOUs, noting that because the Implementation Methodology recognizes elasticity of demand as one of the natural consequences of the five section 7(b)(2) assumptions, BPA would increase the DSI within or adjacent load above the 847 aMW used in the proposal. Kaptur *et al.*,

WP-02-E-BPA-56, at 17. *See also* Section 7(b)(2) Implementation Methodology, b-2-84-F-02, at 19-29; and BPA's Legal Interpretation of Section 7(b)(2), b2-84-FR-03, at 7-8. BPA staff then calculated the difference between the 1,947 aMW of DSI load that BPA is forecasting it will serve in FY 2001 and the 990 aMW that BPA proposed to serve in the Program Case, and multiplied the difference by .856 (the within or adjacent factor). Kaptur *et al*, WP-02-E-BPA-56, at 18. BPA staff concluded that 819 aMW of additional DSI load should be treated as part of the general requirements of 7(b)(2) customers for purposes of the 7(b)(2) Case. *Id.*

The DSIs argue that section 7(b)(2)(A) is not intended to augment the 7(b)(2) customers' loads by arbitrarily transferring to utilities in the 7(b)(2) Case DSI loads that are in existence but not served by BPA in the Program Case. DSI Brief, WP-02-B-DS-01, at 70-71. This, however, is not what BPA has done. BPA has not arbitrarily transferred DSI loads to utilities in the 7(b)(2) Case. Instead, BPA has determined, as discussed in greater detail below, that the power cost differences in the Program and 7(b)(2) Cases alone are sufficient to make the forecasted differences in DSI loads reasonable. The DSIs argue that elasticity addresses price-induced load growth, and the additional amount of DSI load proposed to be added has nothing to do with elasticity of demand. *Id.* To the contrary, again as discussed below, the DSI load proposed to be added is price-induced load growth.

The DSIs argue that the only way BPA would serve the additional load in the 7(b)(2) Case is if BPA were to change its policy on service to the DSIs. *Id.* at 71. The DSIs argue that a change in policy, to serve load in the 7(b)(2) Case that BPA refuses to serve itself and expects to be served by other entities in the Program Case, is not a permitted change in assumptions. *Id.* BPA disagrees with the DSIs' argument that a policy change is necessary for a separate 7(b)(2) Case DSI load forecast. As discussed in more detail below, it is the power cost differences in the Program and 7(b)(2) cases alone that are sufficient to make the forecasted differences in DSI loads reasonable. No change in BPA policy is needed.

The DSIs argue that only if BPA can conclude, based on the record, that changes to its rates cause an increase in DSI load is the natural consequence of elasticity of demand relevant at all. DSI Brief, WP-02-B-DS-01, at 71. As explained below, however, BPA has demonstrated that, based on the record, changes to its rates cause an increase in DSI load. The DSIs argue that there is no relationship between differences in power costs in the Program Case and the 7(b)(2) Case and the additional 819 aMW of DSI load. *Id.* BPA disagrees with the DSIs. The rate case record demonstrates, as discussed in more detail below, that a separate DSI load forecast for the 7(b)(2) Case, with additional DSI load served by the public and cooperative utilities, is reasonable.

The DSIs argue that BPA plainly does not intend to serve the additional 819 aMW at an IP rate, and because the proposed NR rate is sufficiently above the expected market price of power, BPA does not expect to serve the load at NR. *Id.* Therefore, the DSIs argue that the additional load is not "served by the Administrator" as required by section 7(b)(2)(A) of the Northwest Power Act. *Id.* BPA agrees that the 819 aMW is not served by BPA in the Program Case. However, the rate case record shows that a large portion of the 819 aMW would likely be idle capacity in the Program Case, as discussed in greater detail below, and can be defined as price-induced load growth in the 7(b)(2) Case. In addition, the substantial rate difference between the Program Case

IP rate and the 7(b)(2) Case PF rate indicates that the 990 aMW that is “served by the Administrator” in the Program Case would likely increase due to elasticity of demand in the 7(b)(2) Case. BPA has used the 819 aMW as a reasonable proxy for the added DSI load in the 7(b)(2) Case. This increase is caused by the assumed idle capacity in the Program Case coming on-line in the 7(b)(2) Case, as well as price-induced increases to the DSI load “served by the Administrator” in the Program Case.

BPA’s forecast of service to the DSIs in FY 2001 is 1,947 aMW. Kaptur *et al.*, WP-02-E-BPA-56, at 18. BPA’s Program Case forecast of service to the DSIs in FY 2002 is 990 aMW. *Id.* at 18. The DSIs will have access to 1,947 aMW of BPA power at the IP rate on September 30, 2001, and a day later they will have access to 990 aMW of BPA power at the IP rate, according to the assumptions in the Rate Design Step of the RAM. The DSI load no longer served at the IP rate in the Program Case on October 1, 2001, is 957 aMW, the difference between the September 30, 2001, amount of 1,947 aMW and the 990 aMW. This former BPA IP rate load could only be served by expensive market purchases or resources. Therefore, BPA assumes that a large portion of the 957 aMW of DSI load not served at the IP rate in the Program Case will become idle capacity due to high cost of non-IP rate power in the Program Case.

To estimate the cost of power facing the DSI load that is not being served by BPA in the Program Case, BPA first considered its own market price forecast for five-year flat-block purchases, 28.1 mills/kWh. Oliver *et al.*, WP-02-E-BPA-20, at 4. However, 28.1 mills is the expected average price for a limited amount of purchases, 1,562 aMW. *Id.* at 5. Purchases were assumed to be made in 250 aMW blocks, the first of which are expected to be less expensive than the 28.1 mill average, while later 250 aMW blocks are expected to approach the 32.2 mill MCA marginal cost. *Id.* at 4. If an additional 957 aMW of market purchases were assumed to be made by the DSIs in the Program Case, over and above those already made by BPA, the average price of the DSI purchases would exceed BPA’s forecasted 28.1 mills and would likely approach the 32.2 mill MCA marginal cost. Power costs this high would put smelter loads at risk. Alcoa *et al.* argue that even at a 28 mill market price, 68 percent of smelter loads are at risk. Speer *et al.*, WP-02-E-AL/VN/EG-01, at 5. As noted above, later purchases will approach the 32.2 mill level. Oliver *et al.*, WP-02-E-BPA-20, at 4. The likely 30 to 32 mill market price for the last few 250 aMW blocks would certainly put a far larger percentage than 68 percent of DSI smelter loads at risk.

On October 1, 2001, the within and adjacent portions of the 990 aMW DSI load served in the Program Case will be served by public and cooperative utilities in the 7(b)(2) Case. A large percentage, certainly greater than 68 percent, of the within and adjacent portions of the 957 aMW that is considered to be idle capacity due to high market prices in the Program Case can be served by public and cooperative utilities in the 7(b)(2) Case at the 7(b)(2) Case PF rate. The undelivered 7(b)(2) Case PF rate in FY 2002 is 15.88 mills/kWh. Section 7(b)(2) Rate Test Study Documentation, WP-02-E-BPA-06A, at 74. The idle DSI capacity assumed to be induced by high power cost (30-32 mills/kWh) in the Program Case can be served as load growth assumed to be induced by low power cost (15.9 mills/kWh) in the 7(b)(2) Case.

The rate case record shows that the undelivered IP rate in the Program Case in FY 2002 is 20.98 mills/kWh. *Id.* at 40. The over five mills/kWh difference between the rates under which

the DSIs can purchase power in the Program Case, 20.98 mill/kWh, and under which they can purchase power in the 7(b)(2) Case, 15.9 mills/kWh, would induce elasticity of demand load growth in the 7(b)(2) Case DSI load. BPA has used the rate case record to forecast an additional 819 aMW of DSI load placed on the public and cooperative utilities in the 7(b)(2) Case, over and above the 990 aMW of DSI load in the Program Case. This increase is caused by the assumed idle capacity in the Program Case coming online in the 7(b)(2) Case, as well as price-induced increases to the DSI load “served by the Administrator” in the Program Case.

The DSIs argue that the 7(b)(2) rate test directs the Administrator to calculate 7(b)(2) Case costs as if the general requirements of preference customers “had included during such five-year period the direct service industrial customer loads which are – *served by the Administrator* and located within or adjacent to the geographic boundaries of such [customers]” (emphasis added). DSI Ex. Brief, WP-02-R-DS-01, at 29. The DSIs argue that the Draft ROD acknowledged that according to the assumptions in the Rate Design Step of the RAM, BPA’s policy decision to serve no more than 990 aMW of DSI load at statutory rates after September 30, 2001, means that the Program Case forecast of service to the DSIs in FY 2002 is 990 aMW. *Id.*, citing Draft ROD, WP-02-A-01, at 13-41. The DSIs note the Draft ROD declares a large portion of the remaining DSI load (the load assumed not to be served by the Administrator in the Program Case) will stand idle due to the high cost of non-IP rate power in the Program Case, citing Draft ROD, WP-02-A-01, at 13-42. *Id.* The DSIs argue that whether or not load served by the Administrator in the Program Case might operate differently depending on the power price such load might have to bear, it remains load not served by the Administrator in the Program Case. *Id.* The DSIs argue that BPA’s load obligations to the DSIs in this case are established by policy and contract, and therefore the price elasticity of that portion of the DSI load that BPA is not proposing to serve in the Program Case is irrelevant; it is not load served by the Administrator, and BPA cannot assume that it is transferred to public utilities and offered at below-market rates. *Id.* The DSIs note that the entire DSI load served by the Administrator is served under take-or-pay contracts, and thus the 990 aMW served by the Administrator in the Program Case cannot change even if the IP rate in the Program Case and the 7(b)(2) costs in the 7(b)(2) Case differed substantially. *Id.* at 30.

BPA disagrees with the DSIs’ argument that additional DSI load cannot be added to the 7(b)(2) Case. While BPA’s Implementation Methodology recognizes that the within and adjacent portion of the DSI load served by the Administrator in the Program Case will be included in the 7(b)(2) customer load in the 7(b)(2) Case, the Implementation Methodology expressly recognized elasticity of demand as one of the natural consequences of the five section 7(b)(2) assumptions. Implementation Methodology, at 19-29. The Implementation Methodology describes the concept of natural consequences:

Natural consequences, also referred to as secondary effects, result from the relationship of the 7(b)(2) case to the program case: the two cases will be modeled using the same underlying premises and ratemaking procedures. Implementing the five assumptions listed in section 7(b)(2) in the 7(b)(2) case may produce results different from those in the program case when using the same underlying premises and ratemaking procedures used in the program case. These differing results are the natural consequences of the 7(b)(2) assumptions. *See* BPA Legal

Interpretation, 49 Fed. Reg. 23998, 2400-2401 (1984), which contains a full discussion of the legal basis for the recognition of such secondary effects.

Implementation Methodology, at 19. BPA's Legal Interpretation of Section 7(b)(2), 49 Fed. Reg. 23,998 (1984), provides further definition of these natural consequences:

The Administrator will exercise [her] discretionary authority in the following manner. Except for the assumptions specified in section 7(b)(2), all underlying premises will remain constant between the program case and the 7(b)(2) case. Assumptions not specified by the statute will not be considered. The natural consequences, however, of the 7(b)(2) assumptions will be given full recognition in the modeling of the 7(b)(2) customers' power costs in the 7(b)(2) case. This general approach will allow the 7(b)(2) case to be modeled under the same accepted ratemaking techniques used in the program case. This approach will also avoid the modeling of a hypothetical world that attempts to reflect in extreme detail what would have occurred had the Northwest Power Act not been enacted.

...

Legislative history also supports including the natural consequences or unavoidable secondary effects of the assumptions listed in the Northwest Power Act. In particular, in addressing reserve benefits, Appendix B to the Report of the Senate Committee on Energy and Natural Resources provides that in addition to costs specifically described in sections 7(b)(2)(B) and (D), the Administrator is to consider "any other general system operating costs, including reserves . . ." Appendix B at 58.

As an illustration of the natural consequences referred to above, BPA has identified three secondary effects of the five assumptions found in section 7(b)(2). These effects involve demand elasticities, surplus levels and nonfirm energy markets. The secondary effects must be included in section 7(b)(2) methodologies as natural consequences of the five assumptions in section 7(b)(2) on the results of underlying premises that are held constant between the program case and the 7(b)(2) case. For example, implicit in the function of section 7(b)(2) is the possibility that electricity prices may be different under the assumptions contained in section 7(b)(2). Therefore, it could be appropriate to reflect the effects of different price projections in load forecasts used for the two cases. Ignoring these price effects would require adopting a new assumption, not specified in the statute, that the price elasticity of electricity demand for the 7(b)(2) customers is zero (in effect, adding something like this to the statute: "costs calculated pursuant to subsection (A)-(E) of this paragraph shall give only partial effect to the assumptions in those subsections"). An assumption of this nature is theoretically and empirically unjustified and would be inconsistent with the structure of the models used to develop load forecasts for the relevant rate case.

BPA's Legal Interpretation of Section 7(b)(2), at 7-8 (footnotes omitted). More notably, however, the Implementation Methodology expressly addresses the issue raised by the DSIs, noting that DSI loads not in operation due to economic conditions under the Program Case can be in operation in the 7(b)(2) Case. The Implementation Methodology provides:

DSI loads will be input to the rate test model on a plant-by-plant basis. The plants will be flagged to indicate whether they are within or adjacent to the service area of any 7(b)(2) customer based on the list contained in Appendix B. If a DSI leaves the region or is no longer served by BPA, its loads will not be assumed to transfer from BPA service to utility service. Any DSI served by a utility other than BPA in the program case will continue to be served by that utility in the 7(b)(2) case. *However, if a DSI plant is forecast not to operate due to economic conditions under the program case, but projected electric rates are low enough under the 7(b)(2) case to allow a forecasted level of operation, then the load associated with that level of plant operation may be included in the 7(b)(2) case load forecast.*

Implementation Methodology, at 41 (emphasis added). Therefore, BPA can increase the DSI within or adjacent load above the 847 aMW used in the initial proposal. Kaptur *et al*, WP-02-E-BPA-56, at 17. *See* Section 7(b)(2) Implementation Methodology, b-2-84-F-02, at 19-29; and BPA's Legal Interpretation of Section 7(b)(2), b-2-84-FR-03, at 7-8. A separate load forecast can be performed for the 7(b)(2) Case if the monetary amounts in the Program Case and 7(b)(2) Case differ significantly. *See* Section 7(b)(2) Implementation Methodology, b-2-84-F-02, at 23. As one of the natural consequences of the five section 7(b)(2) assumptions and for the reasons discussed above, elasticity of demand can reasonably be assumed to produce a DSI forecast for the 7(b)(2) Case that is larger than the amount of DSI load served by the Administrator in the Program Case. In addition, those DSI loads not served by the Administrator in the Program Case can reasonably be assumed to be idle. In the 7(b)(2) Case world, with its low wholesale rates to public body utilities, that idle capacity would be induced to become active again.

The DSIs argue that often the stated factual basis for resolving one issue is directly contradictory to the factual finding made to resolve other issues. DSI Ex. Brief, WP-02-R-DS-01, at 2. The DSIs also argue that the Draft ROD, for example, justifies the manner in which one sub-issue relating to the 7(b)(2) rate test was modeled by declaring that most DSI plant load not served by BPA will become idle due to the high cost of market-priced power, but justifies the adequacy of the Variable (cost-based indexed IP) rate for DSIs on the ground that at expected aluminum prices, DSI plants face no threat to their operation. *Id.* BPA disagrees with the DSIs' argument that the factual findings concerning DSI plant operations in the 7(b)(2) rate test and the cost-based indexed IP rate for DSIs are contradictory. The two findings occur in very different worlds. The DSI cost-based indexed IP rate is a Subscription Strategy rate and is analyzed from the perspective of BPA's expectations about actual Subscription sales to the DSIs. The section 7(b)(2) rate test 7(b)(2) Case DSI load forecast is analyzed from the perspective of the Rate Design Step in the RAM, which does not contemplate the Subscription Strategy. In addition, while the DSI cost-based indexed IP rate will actually be offered to DSI customers, the

7(b)(2) Case is an artificial world that is modeled following specific directives in the Northwest Power Act.

In the section 7(b)(2) rate test world, the 7(b)(2) Case DSI load forecast assumes a 70 cents/lb. aluminum price. This price is the mid-point between the minimum price of 66 cents/lb. and the maximum price of 74 cents/lb. Miller *et al.*, WP-02-E-BPA-46, at 6. In the section 7(b)(2) rate test Program Case, the DSIs can purchase 990 aMW of BPA power at 25.35 mills/kWh. See Wholesale Power Rate Development Study Documentation, WP-02-E-BPA-05A, at 82. As discussed above, purchases beyond the 990 aMW are likely to be purchased at 30-32 mills/kWh. Oliver *et al.*, WP-02-E-BPA-20, at 4. In addition, the RAM modeling does not model the effects of a cost-based indexed IP DSI rate. The moderate aluminum price combined with a relatively high 7(b)(2) rate test cost of electricity resulted in the assumption that a large amount of DSI load in the section 7(b)(2) rate test Program Case would be idled.

On the other hand, the cost-based indexed IP rate analysis assumed a 74 cent/lb. aluminum price mid-point. The analysis also assumed DSI power purchases from BPA of as much as 1,300 aMW at 23.5 mills/kWh, Miller *et al.*, WP-02-E-BPA-21, at 4; with additional purchases at 28.1 mills/kWh, Oliver *et al.*, WP-02-E-BPA-20, at 7. The higher aluminum price and the lower average cost of purchased power results in an assumption that there is little threat to DSI operations. In summary, where the DSIs saw a contradiction, BPA actually was consistent. The assumptions used in the 7(b)(2) rate test world were reasonable for that world. The assumptions in the DSI Variable rate analysis were reasonable for that purpose. In these examples, low aluminum prices and high energy prices produced a different result than did high aluminum prices and low energy prices. These are not contradictory results as the DSIs allege. They are just two different results.

### **Decision**

*BPA has increased the amount of “within and adjacent” DSI loads above what was included in the initial proposal 7(b)(2) Case. BPA’s forecast of an additional 819 aMW of price-induced DSI load in the 7(b)(2) Case is reasonable and supported by the record.*

## **13.7 BPA’s Rate Development Process**

### **Issue 1**

*Whether BPA’s rate development process is cohesive and produces an end result that properly implements BPA’s policy goals and provides residential and small farm customers proper benefits.*

### **Parties’ Positions**

PGE argues that no one within BPA has exerted overall control in the rate development process to ensure that the end result of that process achieves the agency’s policy goals. PGE Brief, WP-02-B-GE-01, at 2-3. PGE argues that BPA must measure its proposal against BPA’s Subscription Strategy goals. *Id.* at 1. PGE argues that BPA’s rate development process has

produced an end result that does not implement BPA's Subscription Strategy goal of spreading the benefits of the FCRPS widely. *Id.*

### **BPA's Position**

BPA reviewed BPA's policy goals during the rate development process. BPA's proposed rates properly implement the Subscription Strategy goal of spreading the benefits of the FCRPS widely. *See Burns et al.*, WP-02-E-BPA-08, at 7.

### **Evaluation of Positions**

Without citation to authority, PGE argues that no one within BPA has exerted overall control in the rate development process to ensure that the end result of that process achieves the agency's policy goals. PGE Brief, WP-02-B-GE-01, at 2-3. As discussed in greater detail below, there are certain staff functions, *i.e.*, load and resource forecasts, that are technical tasks that reflect the expert analysis of BPA's specialists in those areas. Policy guidance is reflected generally by previous BPA administrative decisions that are reflected in the initial assumptions for an analysis; however, policy guidance is generally unnecessary in performing such studies. While certain BPA employees may not review the end result of the overall process, this does not mean that there are not BPA employees who do review BPA's proposed rates to compare those rates to BPA's policy goals. This is a general review that does not dictate that staff change their technical analyses, but rather compares the results of BPA's proposed rates to BPA's policies. BPA determined that BPA's proposed rates satisfy its policy goals. Ultimately, this is an evaluation made by the Administrator after review of the administrative record.

PGE argues that BPA's rate development process is fragmented and argues that BPA workgroups operated to a considerable extent in isolation from each other, and inputs and assumptions were not measured against BPA's policy goals along the way. PGE Brief, WP-02-B-GE-01, at 2-3. As noted above, it is not necessary to compare each extremely technical analysis performed by expert BPA staff with BPA's policy goals. BPA believes that PGE's argument may be premised on a misunderstanding of the manner in which BPA develops rates. BPA's ratemaking process is complex and uses highly technical studies and data. The various workgroups that produce the technical studies that are part of the rate case record are made up of skilled specialists. When developing, for example, load and resource information, BPA develops the information in the proper technical manner. BPA, at that point, has no need to refer to policy guidance. These are simply technical analyses. The 7(b)(2) rate test workgroup, and the workgroup responsible for calculating posted rates for this rate case, properly relied on many other workgroups in BPA to furnish studies and data. Kaptur *et al.*, WP-02-E-BPA-56, at 7-8. The 7(b)(2) and rates workgroups had neither the knowledge nor the inclination to second guess the actual experts in their fields that provided their technical information to the section 7(b)(2) and rates workgroups, nor alter the data they received from other specialists in order to arrive at some predetermined or biased outcome. The 7(b)(2) and rates workgroups used the data provided by other experts within BPA and did their analyses by following their understanding of the Northwest Power Act and the Section 7(b)(2) Implementation Methodology ROD. Tr. 2163.

BPA's rate analyses are technical matters that produce technical results and are not policy issues. BPA managers have not directed these groups to produce specific predetermined results.

Tr. 125. This is the proper way to develop rates. To suggest that each technical issue addressed by BPA must be compared to BPA policy makes little sense. Nevertheless, a review of BPA's 2002 power rates demonstrates that BPA has achieved its policy goals. With regard to the goal of spreading the benefits of the FCRPS as broadly as possible, with special attention given to the residential and rural customers of the region, BPA has achieved this goal, in part, by proposing to offer settlements of the REP (which include a proposed 1,800 [1900] aMW of benefits in power and money) for which BPA has proposed the RL and PF Exchange Subscription rates. Furthermore, BPA's forecasted Residential Exchange benefits to the IOUs total approximately \$37 million per year during the rate period. Wholesale Power Rate Development Study Documentation, WP-02-E-BPA-05A, at 91. In providing special attention to residential and rural customers of the IOUs and giving them an additional option in access to Federal benefits, BPA forecasted Exchange settlement benefits to the IOUs that total approximately \$140 million per year during the rate period. Tr. 122. To suggest that BPA is not giving special attention to the region's residential and rural customers of IOUs is simply incorrect.

Similarly, with regard to the goal of avoiding rate increases through a creative and business-like response to markets and additional aggressive cost reductions, BPA proposed rates to PF Preference customers that have avoided a rate increase and thereby provided rate stability. With regard to allowing BPA to fulfill its fish and wildlife obligations while assuring a high probability of U.S. Treasury payment, BPA proposed rates that allow for the recovery of the costs of BPA's fish and wildlife obligations and which achieve an 88 percent TPP. With regard to providing market incentives for the development of conservation and renewables as part of a broader BPA leadership role in the regional effort to capture the value of these and other emerging technologies, BPA proposed the C&R Discount and the acquisition of additional conservation. Therefore, BPA is aware of its policy goals in designing rates and believes that the 2002 power rates satisfy those goals.

### **Decision**

*BPA's rate development process is cohesive, and the 2002 power rates implement BPA's Subscription Strategy goals.*

### **Issue 2**

*Whether BPA used proper inputs and assumptions in its conduct of the 7(b)(2) rate test and whether those assumptions were tied to those used in BPA's 1996 rate case.*

### **Parties' Positions**

PGE argues that BPA incorrectly used the inputs and assumptions borrowed from the 1996 rate case to perform the 7(b)(2) rate test, and that correcting these inputs and assumptions would yield higher Residential Exchange benefits. PGE Brief, WP-02-B-GE-01, at 4-5. The IOUs argue that in 1996, BPA changed various 7(b)(2) rate test assumptions in order to cut rates to DSI customers and keep them from leaving BPA. IOU Brief,

WP-02-B-AC/GE/IP/MP/PL/PS-01, at 16. The IOUs argue that because BPA's 7(b)(2) panel did not go back and correct the assumptions BPA made in the 1996 7(b)(2) rate test to cut rates to the DSIs, the end result is reduced REP benefits. *Id.* The DSIs argue that the IOUs' claim that the 7(b)(2) rate test was manipulated to pay for a lower rate for the DSIs is baseless. Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06, at 14-15.

### **BPA's Position**

The 7(b)(2) rate test in 1996 was properly conducted by BPA. Boling and Doubleday, WP-02-E-BPA-53, at 12-13. BPA is not relying on BPA's 1996 rate case decisions as binding and has evaluated all 7(b)(2) issues in the current proceeding. If certain positions are similar to previous rate cases, going back to 1985, it is because BPA believes that such positions are correct. *Id.* at 14. BPA did not change various 7(b)(2) rate test assumptions in 1996 in order to cut rates to DSI customers and keep them from leaving BPA. Kaptur *et al.*, WP-02-E-BPA-56, at 2-5. Residential Exchange benefits are calculated by comparing a utility's ASC with BPA's PF Exchange Program rate. *See, e.g.*, Boling and Doubleday, WP-02-E-BPA-30, at 2.

### **Evaluation of Positions**

PGE argues that the workgroup that performed the 7(b)(2) rate test performed no calculation of the amount of Residential Exchange benefits the residential and small farm customers of the IOUs would receive, compared to the benefits provided to BPA's other residential customers through access to power at the PF Preference rate. PGE Brief, WP-02-B-GE-01, at 4-5, citing Tr. 2111. PGE has misrepresented BPA's cross-examination testimony. The cited testimony concerning possible calculations performed by the 7(b)(2) panel consists of one question and answer:

Q. (Mr. Marshall) Have you done any calculations of the percentages of benefits to the residential rural customers of Northwest IOUs under BPA's settlement proposal?

A. (Mr. Keep) No, I have not.

Tr. 2111.

PGE's argument above refers to benefits under the traditional REP, while the cited question and answer above refers to benefits under BPA's settlement proposal. The calculations done by the 7(b)(2) panel result in the determination of the 7(b)(2) rate test trigger amount. That trigger amount has some impact on the level of the PF Exchange Program rate. The level of the PF Exchange Program rate has some impact on the amount of benefits under the traditional REP. However, the calculations done by the 7(b)(2) panel have no impact on the level of BPA's settlement proposal benefits. The 7(b)(2) panel would not, as a normal part of their duties, calculate traditional REP benefits, nor would they compare those benefits with the benefits enjoyed by other customer groups.

PGE argues that the 7(b)(2) panel did not independently consider the objectives of the Northwest Power Act with regard to benefits under the REP, and did not examine the end result produced by their calculations of the 7(b)(2) test. PGE Brief, WP-02-B-GE-01, at 5. The IOUs fail to recognize, however, that the determination of the objectives of the Northwest Power Act is a legal matter. Because the 7(b)(2) witnesses are not lawyers, they would not be expected to provide a legal analysis of the objectives of the Northwest Power Act. The witnesses, however, do have their own understanding of the Northwest Power Act. As noted below, BPA believes that BPA's implementation of the 7(b)(2) rate test in the current rate case, the end result of the rate case, and BPA's 2002 power rates are perfectly consistent with the Northwest Power Act and the legislative history of the Northwest Power Act. In addition, as discussed in ROD chapter 14, there is no end results test that is applicable to BPA's ratemaking. Furthermore, BPA has been developing rates under the Northwest Power Act for nearly 20 years. In each rate case BPA has conducted, BPA has implemented the same statutory rate directives as in the previous rate case, and subject to the changes in the rate directives beginning in 1985. In addition, BPA reviewed the Northwest Power Act and its legislative history in developing BPA's Legal Interpretation of Section 7(b)(2) in 1984, b-2-84-FR-03. BPA also reviewed the Northwest Power Act and its legislative history in developing BPA's Section 7(b)(2) Implementation Methodology in 1984, b-2-84-F-02. BPA also has conducted the 7(b)(2) rate test in every rate case since 1985, except in the cases where the rate case was settled and the test was not performed. In summary, BPA is extremely familiar with the 7(b)(2) rate test and the Congressional intent behind the test. This makes a comparison of the results of the rate test with Congressional intent an inherent part of the rate test. BPA's extensive review of the legislative intent of the 7(b)(2) rate test is found throughout this chapter of the ROD. After reviewing BPA's implementation of the 7(b)(2) rate test in the current rate case, the end result of the rate case and BPA's 2002 power rates are perfectly consistent with the Northwest Power Act, the legislative history of the Northwest Power Act, and other applicable rules.

PGE and the IOUs argue that BPA's 7(b)(2) panel felt constrained to calculate the 7(b)(2) rate test in the same manner that the test was performed in the 1996 rate case. PGE Brief, WP-02-B-GE-01, at 5; IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 16. BPA disagrees. In making this argument, the IOUs cite Kaptur *et al.*, WP-02-E-BPA-56, at 5, 7-8. *Id.* In BPA's review of page 5 of the cited testimony, BPA can find no statement that BPA's witnesses felt constrained by manner that the test was performed in the 1996 rate case. In reviewing pages 7 and 8 of the cited testimony, BPA also can find no statement that BPA's witnesses felt so constrained. Indeed, pages 7 and 8 do not even reference 1996. While BPA clearly did not feel constrained to follow BPA's 1996 rate test, in conducting the rate test it is likely that BPA's positions on many issues will be the same as in BPA's previous rate cases, not because BPA is relying on 1996 decisions or assumptions, but rather because the same issues arise in each rate case and BPA has been conducting the 7(b)(2) rate test since 1985. BPA has implemented consistent interpretations of section 7(b)(2), the Section 7(b)(2) Implementation Methodology, and BPA's Legal Interpretation of Section 7(b)(2). BPA's understanding of the Northwest Power Act, the Section 7(b)(2) Implementation Methodology ROD, and BPA's Legal Interpretation of Section 7(b)(2) can be traced back to rate cases in the mid-1980s, not BPA's 1996 rate case. Tr. 2149-50; Tr. 2218. BPA still conducts independent evaluations of each issue, however, as reflected in BPA's studies, documentation and testimony filed in this rate case. This information is specific to this rate case, and is not relying on any previous rate case.

Because these issues are analyzed for each rate case, BPA's studies, documentation and testimony ensure that BPA's determinations are accurate. There are many specific rules that BPA must follow in developing rates. These rules leave little room for discretion on BPA's part. The results of the 7(b)(2) rate test reflect BPA's best determination of the issues that comprise the rate test. As noted in BPA's testimony, "[e]ach issue regarding the 7(b)(2) rate test is considered and determined on its merits. Similarly, other rate case issues must be determined on their merits." Boling and Doubleday, WP-02-E-BPA-53, at 18.

PGE and the IOUs argue that BPA made several adjustments to the 1996 7(b)(2) test to ensure that BPA's rates were sufficiently competitive to retain its DSI customers. PGE Brief, WP-02-B-GE-01, at 5; IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 16. PGE argues that even though in the current rate case BPA does not face these same competitive pressures, BPA has not corrected the adjustments made to the 7(b)(2) test in 1996. PGE Brief, WP-02-B-GE-01, at 5. The IOUs also argue that because BPA's 7(b)(2) panel did not go back and correct the assumptions BPA made in the 1996 7(b)(2) rate test to cut rates to the DSIs, the end result is reduced REP benefits. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 16. BPA disagrees with these arguments. PGE and the IOUs first allude to major changes made in BPA's 1996 7(b)(2) rate test assumptions, while explicitly mentioning only three changes they contend that BPA should make in the current case. PGE Brief, WP-02-B-GE-01, at 5-11; IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 14-29. First, as noted previously, BPA did not make adjustments to the 1996 7(b)(2) rate test in order to retain its DSI customers. Upon further review, however, the adjustments alleged by the IOUs to have occurred in 1996 were not made again in the current rate case. The first change proposed by the IOUs is to treat conservation costs as FBS resource costs. After review of BPA's previous rate case RODs, BPA knows it has never treated conservation costs as FBS costs, not in BPA's 1996 rate case or any other previous rate case. Similarly, parties to previous rate cases have never even proposed that conservation should be treated as an FBS resource. Obviously, this cannot be an adjustment that BPA is continuing. The second change proposed by the IOUs is to define the term "uncontrollable events" to include PNRR and the termination of generating facilities. As with the previous discussion of conservation costs, after review of BPA's previous rate case RODs, BPA knows that it has never defined PNRR or the costs of terminated thermal generating plants as the costs of "uncontrollable events," not in the 1996 rate case or any other previous rate case. Similarly, parties in previous rate cases have never proposed that PNRR or the costs of terminated thermal generating plants be defined as the costs of "uncontrollable events." Since these changes being proposed by the IOUs are not associated with the way the 1996 7(b)(2) rate test was conducted, BPA cannot be continuing any alleged adjustment on these issues. The third change proposed by the IOUs involves the way in which the DSI net margin is calculated. This proposed change is not a section 7(b)(2) issue and is addressed in ROD chapter 15. In any event, the effect of the DSI margin assumption on the 7(b)(2) rate test trigger is minor, at most 0.2 mills/kWh, based on the IOUs' own testimony. Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06, at 14-15, citing Hoff *et al.*, WP-02-E-AC/GE/IP/MP/PL/PS-03, at 13, 19.

The IOUs also alleged elsewhere that BPA improperly continued a list of past mistakes in conducting the section 7(b)(2) rate test. Hoff *et al.*, WP-02-E-AC/GE/IP/MP/PL/PS-03, at 6-7. The first of these issues concerns BPA's ASC Methodology, which was developed in a separate administrative proceeding in 1984 and is not established in BPA's rate cases. This procedural

issue is addressed in detail in the current proceeding. *See* ROD section 11.2. Because it is not a substantive rate case issue, it is not a continuing rate case “mistake.” Another issue mentioned by the IOUs is BPA’s 1996 alleged failure to equalize cash reserve accumulations in the Program Case and 7(b)(2) Case. The IOUs did not raise this issue in BPA’s current rate case. Because they have not raised the issue in the current proceeding, and it is not a contested issue, it is inappropriate to refer to it as a continuing mistake. Another issue mentioned by the IOUs is BPA’s 1996 alleged failure to limit the cash reserve accumulation. This is a revenue requirement issue and again, the IOUs did not raise this issue in BPA’s current rate case. Because they have not raised the issue, and it is not a contested issue, it is inappropriate to refer to it as a continuing mistake. Another issue referenced by the IOUs is BPA’s alleged failure to include the proper amount of section 7(g) costs as uncontrollable events in the 7(b)(2) rate test. This issue is being addressed in BPA’s current rate case. The issues regarding uncontrollable events in the current case, however, are *different* issues from those addressed in BPA’s 1996 rate case. As noted above, the current case involves PNRR and the costs of terminated generating facilities, arguments that were not raised by any party in BPA’s 1996 rate case. Draft ROD, WP-02-A-01, section 13.3. Therefore, these issues cannot be continuing mistakes, as they are new issues. Another issue identified by the IOUs is the issue of calculating Mid-C resource availability and costs. This issue did not affect the development of BPA’s rates in 1996 in any manner whatsoever, because the circumstances for implementing this issue did not arise. In addition, this issue is moot in the current rate case. Draft ROD, WP-02-A-01, section 13.5. It is inappropriate to refer to this issue as a continuing mistake when it did not affect BPA’s 1996 rates and the issue is moot in the current rate case. Another issue referenced by the IOUs is the inclusion of a 7(b)(2) industrial adjustment in a 7(c)(2) delta calculation. This is a COSA issue and not a section 7(b)(2) rate test issue. More importantly, however, the IOUs did not raise this issue in BPA’s current rate case. Because they have not raised the issue, and it is not a contested issue, it is inappropriate to refer to it as a continuing mistake. In summary, the IOUs’ argument that BPA has continued mistakes from its 1996 rate case has little merit. The foregoing changes proposed by the IOUs (excluding the DSI margin), are addressed separately in greater detail in this chapter of the ROD.

As noted above, the IOUs and PGE argue that BPA misapplied the 7(b)(2) rate test in the 1996 rate case to arrive at a predetermined outcome, which was to keep DSI customers from leaving BPA. PGE Brief, WP-02-B-GE-01, at 5; IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 16. BPA disagrees with PGE’s and the IOUs’ argument, just as BPA disagreed with this argument in BPA’s 1996 rate case. Boling and Doubleday, WP-02-E-BPA-53, at 12-13. In its WP-02 rebuttal testimony, BPA attached its 1996 rebuttal testimony responding to the testimony the IOUs attached to their WP-02 direct testimony. *Id.*, Attachment 1, Testimony of Marshall and Burns, WP-96-E-BPA-44. All such issues regarding BPA’s 1996 rate case were addressed in BPA’s 1996 ROD, WP-96-A-02. Boling and Doubleday, WP-02-E-BPA-53, at 13, Attachment 2. FERC granted final approval of BPA’s rates, and the only petition for review filed with the United States Court of Appeals for the Ninth Circuit was voluntarily dismissed. Boling and Doubleday, WP-02-E-BPA-53, at 13. BPA’s 1996 rates are final. *Id.*

Furthermore, triggering the 7(b)(2) rate test is not an effective tool to lower the cost of power sold to the DSIs. Kaptur *et al.*, WP-02-E-BPA-56, at 3. When the 7(b)(2) rate test triggers positively, it allocates PF Preference protection costs to the DSI rate class. *Id.* Those costs

remain even after the section 7(c)(2) adjustment links the IP rate to the now lower PF Preference rate. In BPA's 1996 final rate proposal, the 7(b)(2) rate test triggered by 3.2 mills, providing \$621.4 million in rate protection to the PF Preference rate class over five years. *Id.*; see 1996 Wholesale Power Rate Development Study Documentation, WP-96-FS-BPA-05A, page 195, Table RDS 30, line 3. Before the rate test triggered, the costs allocated to the DSI rate class were \$1,556.6 million for five years. Kaptur *et al.*, WP-02-E-BPA-56, at 4. After the rate test triggered by 3.2 mills and the IP-PF link was reestablished, the costs allocated to the DSI rate class were \$1,539.3 for five years, a reduction of about a 1 percent, or just \$3.5 million per year. *Id.*; see 1996 Wholesale Power Rate Development Study Documentation, WP-96-FS-BPA-05A, page 197, Table RDS 33. The alleged massive reallocation of benefits from residential customers of IOUs to the DSIs did not happen in BPA's 1996 rate case. *Id.*

The Joint DSIs also established that the IOUs' claim that the 7(b)(2) rate test was manipulated to pay for a lower rate for the DSIs is baseless. Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06, at 14-15. The Joint DSIs note that while decisions on DSI issues can affect the 7(b)(2) rate test, the accusation that the 7(b)(2) rate test provided benefits for the DSIs is completely unsupported. *Id.* The Joint DSIs note that issues regarding the 7(c)(2) floor rate test and the industrial margin have a small impact on the 7(b)(2) rate test, and to implicate these decisions as the cause of a large change in the rate test trigger is unfounded. *Id.* In the rate case, the combined effect of changing the floor rate and margin to the IOUs' position, ignoring that they are completely in error on the value of reserves exclusion from the floor rate, is at most 0.2 mills/kWh, based on the IOUs' own testimony. *Id.* The Joint DSIs also note that in BPA's 1996 rate case, the IP-96 rate was allocated \$240,994,000 of the costs of providing the 7(b)(2) protection to the preference customers. *Id.* Then, \$258,250,000 was restored to the IP rate through linkage of the IP rate to the PF Preference rate. *Id.* The difference, \$17,256,000 spread over five years, was the total benefit realized by the DSIs in the IP rate through the 7(b)(2) rate test. *Id.* This equals 0.07 mills/kWh benefit. *Id.* To accuse BPA of manipulating the rate test in order to provide less than one-tenth of a mill benefit to the DSIs is simply not credible. *Id.*

### **Decision**

*The 7(b)(2) rate test was properly conducted in BPA's 1996 rate case. BPA does not rely on BPA's 1996 rate case decisions as binding and has evaluated all 7(b)(2) issues in the current proceeding. If certain positions are similar to previous rate cases, going back to 1985, it is because BPA believes that such positions are correct. BPA uses proper inputs and assumptions in its conduct of the 7(b)(2) rate test. The 7(b)(2) rate test has been performed properly in the current rate case.*